

No. 15273

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United States  
Court of Appeals  
for the Ninth Circuit

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PACIFIC VEGETABLE OIL CORPORATION,  
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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Transcript of Record

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Petition to Review a Decision of The Tax Court  
of the United States

FILED

JAN 14 1957

PAUL P. O'BRIEN, CLERK



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Court of Appeals  
for the Ninth Circuit

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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## NAMES AND ADDRESSES OF ATTORNEYS

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San Francisco, California,  
Attorney for Petitioner.

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Washington 25, D. C.  
Attorneys for Respondent.



The Tax Court of the United States

Docket No. 50344

PACIFIC VEGETABLE OIL CORPORATION,  
a corporation, Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

Appearances:

For Petitioner: Dudley F. Miller, Esq.

For Respondent: Edward H. Boyle, Jr., Esq.

DOCKET ENTRIES

1953

Aug. 31—Petition received and filed. Taxpayer notified. Fee paid.

Sept. 1—Copy of petition served on General Counsel.

Oct. 13—Answer filed by General Counsel.

Oct. 13—Request for hearing in San Francisco, California filed by General Counsel.

Oct. 16—Notice issued placing proceeding on San Francisco, California calendar. Service of answer and request made.

1955

Mar. 31—Hearing set July 5, 1955, San Francisco, California.

Apr. 20—Notice hearing changed to 6/27/55, San Francisco, California.

1955

- Jun.    28—Hearing had before Judge Harron, on  
          the merits. Stipulation of facts filed at  
          hearing. Briefs due 9/19/55. Replies  
          due 10/21/55.
- Jul.    13—Transcript of hearing 6/28/55 filed.
- Sept.   19—Brief filed by taxpayer. 9/20/55 Copy  
          served.
- Sept.   19—Brief filed by General Counsel.
- Oct.    21—Reply brief filed by taxpayer. 10/24/55  
          Copy served.

1956

- Apr.    5—Findings of fact and opinion filed, Har-  
          ron, Judge. Decision will be entered  
          for respondent. 4/5/56 Served.
- Apr.    5—Decision entered, Judge, Harron, Div.  
          13.
- Jul.    2—Petition for review by United States  
          Court of Appeals, Ninth Circuit, with  
          notice of filing and affidavit of service  
          by mail attached, filed.
- Jul.    19—Designation of Record on review with  
          proof of service thereon, filed.

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[Title of Tax Court and Cause.]

## PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency in income tax liability set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Appellate Division—Los Angeles District, Room 710, 630 San-

some Street, San Francisco 11, California: ADC-Ap:LA SF:LB:HVVH-90-D) dated June 5, 1953, and as the basis of its proceeding alleges as follows:

### I.

Petitioner is a corporation duly organized and existing under and by virtue of the laws of the State of California, with its principal place of business at 62 Townsend Street, in the City and County of San Francisco, State of California. The income tax return of petitioner for the year involved in this proceeding was filed with the Collector of Internal Revenue, First California District at San Francisco, California.

### II.

The Notice of Deficiency, a copy of which is attached hereto and marked Exhibit "A" was mailed to petitioner on June 5, 1953.

### III.

The taxes in controversy are corporate income taxes for the calendar year ending December 31, 1949, the deficiency asserted therein being \$148,-867.81, the amount in issue being the sum of \$112,960.50.

### IV.

The determination of the taxes set forth in said Notice of Deficiency is based upon the following errors:

1. The Commissioner of Internal Revenue erred in disallowing as a deduction from gross sales the

amount of \$159,256.16 representing the balance on December 31, 1949, in an account designated "Reserve for Outturn Settlements" which account applied exclusively to contracts covering in transit copra shipments.

2. The Commissioner of Internal Revenue erred in including in gross income the said amount of \$159,256.16, or any part thereof, which amount represented unascertainable and wholly contingent claims to future income.

3. The Commissioner of Internal Revenue erred in holding that the accounting method of making allowance for such outturn settlements used by the petitioner in years prior to 1949 properly reflected income.

4. The Commissioner of Internal Revenue erred in holding that said deduction of said amount of \$159,256.16 in the year 1949 as a reserve for outturn settlements upon contracts covering copra shipments in transit at December 31, 1949 represented a change in method of accounting for which permission was required to be secured from the Commissioner of Internal Revenue.

5. The Commissioner of Internal Revenue erred in holding said amount of \$159,256.16 represented contingent liabilities not definitely accrued in the taxable year.

6. The Commissioner of Internal Revenue erred in failing to hold that said amount of \$159,256.16 represented unascertainable and wholly contingent claims to future income.

7. The Commissioner of Internal Revenue erred

in eliminating from petitioner's net income for said taxable year dividend income of \$296,120.00 representing the amount received by petitioner in 1949 from Western Vegetable Oils Company Incorporated, a corporation.

8. The Commissioner of Internal Revenue erred in refusing to allow as a credit against net income the sum of \$251,702.00 representing 85% of dividends totaling \$296,120.00 received by petitioner in 1949 from a domestic corporation, Western Vegetable Oils Company, Incorporated.

9. The Commissioner of Internal Revenue erred in his determination that petitioner realized capital gain in the amount of \$277,288.00, or any part of said amount, from the distribution made by Western Vegetable Oils Company, Incorporated, in 1949 to petitioner in the sum of \$296,120.00.

10. The Commissioner of Internal Revenue erred in increasing petitioner's income tax liability for said taxable year by the sum of \$69,322.00 representing 25% of said alleged capital gain of \$277,288.00.

11. The Commissioner of Internal Revenue erred in including in petitioner's income for said taxable year any capital gain arising from the distribution in 1949 of the sum of \$296,120.00 to petitioner from Western Vegetable Oils Company, Incorporated.

12. The Commissioner of Internal Revenue erred in his determination of the net taxable income of petitioner for the calendar year 1949 and in assessing any deficiency against petitioner for said year in excess of the sum of \$35,907.31.



## V.

A. The facts upon which petitioner relies as the basis of this proceeding relating to assignments of error Nos. 1 to 6 inclusive and No. 12 are as follows:

1. Petitioner is engaged in the business of manufacturing, processing, handling and dealing in vegetable oils and vegetable oil raw materials in the United States and elsewhere in the world. As a part of its operations petitioner purchases copra, the raw material from which coconut oil is manufactured, in the Philippine Islands and sells the same to purchasers elsewhere in the world, chiefly in Europe and Latin-America.

2. The majority of all the petitioner's sales of copra are made under written contracts providing for payment for the quantity delivered to the buyer on the basis of landed weights, i.e., on the basis of the quantity actually delivered at destination. These contracts also provide that payment shall be made by the buyer for 95% of the quantity shipped by draft against shipping documents. In the event that the price payable upon a landed weight basis exceeds or is less than said 95% of the purchase price so received, appropriate settlement is made between seller and buyer.

3. All copra contains varying amounts of moisture at the time of shipment and some shrinkage in transit is commonly experienced. Actual shrinkages on individual shipments may vary over a wide range, from no shrinkage to shrinkage as high as 10% or 12% of the quantity shipped.

4. Petitioner, on its copra shipments, experi-



ences a shrinkage in excess of 4% and in the calendar year 1949 experienced an average actual shrinkage of 4.31%. By the terms of said sales contracts only 95% of the invoice value of the copra shipped is collectible until the cargo has arrived at destination and landed weights are determined and at that time only any excess of landed weights over shipped weights is collectible. Prior to the calendar year 1949 petitioner followed a practice of crediting sales income with 100% of the invoice value of each shipment on the basis of shipped weights, subsequently deducting from sales income at some later date the value of the shrinkage actually experienced in transit. This practice resulted in a continual over-statement of sales income. For the calendar year 1949 petitioner adopted the practice of crediting sales income at time of shipment only with the amount collectible at time of shipment, namely 95% of the invoice value of the quantity shipped, the remaining 5% being set up as contingent income in an account called a reserve for outturn settlements. Upon receipt of actual landed weights an adjusting entry is made eliminating the reserve applicable to the particular shipment and crediting sales for any additional amount receivable and charging sales for any amount refundable to the buyer. Said amount of \$159,256.16 standing in said reserve at December 31, 1949 and deducted by petitioner from gross sales for said year represents the 5% balance uncollectible and uncollected on specific sales contracts with respect to which landed weights had not then been determined.

B. The facts upon which petitioner relies as the basis of this proceeding relating to assignments of error Nos. 7 to 12 inclusive are as follows:

1. Prior to the calendar year 1949 petitioner owned 2,094 of the 5,182 shares of capital stock of Western Vegetable Oils Company, Incorporated, then issued and outstanding.

2. On December 31, 1948 said Western Vegetable Oils Company, Incorporated, had earnings and profits accumulated subsequent to February 28, 1913, in an amount not less than \$768,299.64.

3. On December 31, 1948 Western Vegetable Oils Company, Incorporated, held cash in the amount of \$448,201.72 and was possessed of other quick assets.

4. During the calendar year 1949 Western Vegetable Oils Company, Incorporated, purchased 2,032 shares of its outstanding capital stock for a total consideration of \$433,040.00.

5. Of said 2,032 shares, 1,346 shares were acquired from petitioner for a total consideration of \$296,120.00.

6. On December 31, 1949 Western Vegetable Oils Company, Incorporated, held cash in the amount of \$238,503.21 and had 3,150 shares of capital stock outstanding.

7. The entire purchase price of \$433,040.00 paid by Western Vegetable Oils Company, Incorporated, in 1949 for said 2,032 shares of capital stock was charged to the earned surplus account of said Western Vegetable Oils Company, Incorporated.

8. On December 31, 1949 said Western Vegetable Oils Company, Incorporated, had earnings and prof-

its accumulated subsequent to February 28, 1913 in an amount not less than \$503,756.80.

9. At all times subsequent to its purchase of said 2,032 shares of capital stock Western Vegetable Oils Company, Incorporated, has had sufficient funds to finance its normal business operation, has held the same plant and equipment and has continued to conduct its business in the same manner as prior to said purchases of capital stock.

Wherefore, petitioner prays that this Court may hear this proceeding and determine that there is no deficiency in income taxes for the calendar year 1949 due from petitioner herein in excess of the sum of \$35,907.31, and for such other and further relief as to this Court may seem meet and proper in the premises.

/s/ DUDLEY F. MILLER  
Counsel for Petitioner

Duly Verified.

EXHIBIT "A"

U. S. Treasury Department, Office of the District  
Commissioner, Internal Revenue Service, Ap-  
pellate Division, Los Angeles District, Room  
710, 630 Sansome Street, San Francisco 11,  
California. June 5, 1953

In Replying Refer to: ADC-Ap:LA SF:LB:HVB-  
90-D.

Pacific Vegetable Oil Corporation  
62 Townsend Street, San Francisco, California.

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year 1949 discloses a deficiency of \$148,867.81, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant District Commissioner, Appellate, Room 710, 630 Sansome Street, San Francisco 11, California. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours,

T. COLEMAN ANDREWS

Commissioner

/s/ By WM. G. WILKER

Assistant Head, Appellate Division

Enclosures: Statement, Form 1276, Agreement Form.

# STATEMENT

Tax Liability for the Taxable Year Ended

December 31, 1949

Year	Liability	Assessed	Deficiency
1949	\$189,303.58	\$40,435.77	\$148,867.81

In making this determination of your income tax liability, careful consideration has been given to your protest dated November 8, 1951 and to the statements made at the conferences held on August 27, 1952, October 24, 1952 and April 1, 1953.

## Adjustments to Net Income

Year: 1949

Net income as disclosed by return	\$375,910.91
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Unallowable deductions and additional income:

(a) Reserve for settlement allowances	\$159,256.16	
(b) Net long-term capital gain	277,288.00	
(c) "Lifo" inventory adjustment	85,821.41	
(d) Depreciation allowance decreased	8,841.03	531,206.60

Total		\$907,117.51
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Nontaxable income and additional deductions

(e) Dividends	\$296,120.00	
(f) Franchise tax	169.50	296,289.50

Net income as adjusted		\$610,828.01
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is taxable as long-term capital gain realized from the sale or other disposition of property in the amount calculated as follows:

Proceeds from 1346 shares	\$296,120.00
Cost Basis of stock sold	18,832.00
Long-term capital gain	<u>\$277,288.00</u>

Accordingly dividend income of \$296,120.00 and the offsetting credit of \$251,702.00 are eliminated from your net income and the long-term capital gain of \$277,288.00 is substituted therefor.

(c) In 1949 inventories were priced at the lower of cost or market except for copra and flaxseed which were priced at "Lifo." In 1950 you elected to go on the "Lifo" method of pricing certain other commodities. Taxable income for the year 1949 is increased \$85,821.41 as a result of this change in the method of pricing these commodities. The increase is computed as follows:

Date	Description	Valued at Lower of Cost or Market	Valued at Cost	Write-down from cost to Market
12/31/49	Soybeans	\$ 55,530.84	\$ 55,530.84	\$ 0.00
	Crude linseed oil	479,268.46	480,781.25	1,512.79
	Crude coconut oil	32,058.93	32,058.93	0.00
	Crude wood oil	252,360.15	252,360.15	0.00
	Crude fish oil	159,238.86	232,782.58	73,543.72
	Crude soya oil	49,196.28	49,196.28	0.00
	Plain & Fancy tallow	92,477.97	103,242.87	10,764.90
	Edible tallow	16,605.57	16,605.57	0.00
	Totals	<u>\$1,136,737.06</u>	<u>\$1,222,558.47</u>	<u>\$85,821.41</u>

(d) The deduction for depreciation is decreased \$8,841.03 due to the increase in estimated life of

certain machinery and equipment from eight years, as claimed on your return, to ten years.

(e) See item (b)

(f) Deduction for California franchise tax is increased \$169.50 as follows:

Increase in franchise tax based on adjustments to 1948 income (as disclosed by Franchise Tax Board letter dated May 22, 1951)	\$1,917.89
Less: 1946 deficiency claimed on 1949 return	1,748.39
Net increase	<u>\$ 169.50</u>

The 1946 deficiency claimed on your 1949 return was allowed as a deduction in the previous determination of your 1946 Federal income tax liability.

### Computation of Tax—Year 1949

#### Alternative Tax:

Net income			\$610,828.01
Less: Excess of net long-term capital gain over net short-term capital gain			277,288.00
Ordinary net income			<u>\$333,540.01</u>
Dividends received credit:			
	Dividends	Credit at 85%	
Disclosed by return	\$317,060.00	\$269,501.00	
Reduction herein	296,120.00	251,702.00	
As revised	<u>\$ 20,940.00</u>	<u>\$ 17,799.00</u>	17,799.00
Net income subject to normal tax and surtax			<u>\$315,741.01</u>
Normal tax at 24%			\$ 75,777.84
Surtax at 14%			44,203.74
Total normal tax and surtax (partial tax)			<u>\$119,981.58</u>
Add: 25% of excess of net long-term capital gain over net short-term capital gain			69,322.00
Alternative tax			<u><u>\$189,303.58</u></u>

## Tax at ordinary rates:

Net income	\$610,828.01
Less: Dividends received credit as disclosed by the foregoing	17,799.00
Net income subject to normal tax and surtax	<u>\$593,029.01</u>
Normal tax at 24%	\$142,326.96
Surtax at 14%	83,024.06
Income tax at ordinary rates	<u>\$225,351.02</u>
Income tax liability (alternative tax)	<u>\$189,303.58</u>
Income tax assessed:	
Original Account No. 4101598, First California District	40,435.77
Deficiency in income tax	<u>\$148,867.81</u>

[Endorsed]: T.C.U.S. Filed Aug. 31, 1953.

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[Title of Tax Court and Cause.]

## ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Kenneth W. Gemmill, Acting Chief Counsel, Internal Revenue Service, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

## I. and II.

Admits the allegations in paragraphs I and II.

## III.

Admits that the taxes in controversy are corporate income taxes for the calendar year ending December 31, 1949, the deficiency asserted therein be-



ing \$148,867.81; denies the remaining allegations in paragraph III.

#### IV.

1. to 12., inclusive. Denies the allegations of error in subparagraphs 1 to 12, inclusive, of paragraph IV.

#### V.

A. 1. and 2. Admits the allegations in subparagraphs A. 1 and 2 of paragraph V.

A. 3. Admits that all copra contains varying amounts of moisture at the time of shipment and some shrinkage in transit is commonly experienced; denies the remaining allegations in subparagraph A. 3 of paragraph V.

A. 4. For lack of information, denies the allegations in subparagraph A. 4 of paragraph V.

B. 1. Admits the allegations contained in subparagraph B. 1. of paragraph V.

B. 2., 3., and 4. For lack of information, denies the allegations in subparagraphs B. 2., 3., and 4. of paragraph V.

B. 5. Admits the allegations in subparagraph B. 5 of paragraph V.

B. 6. to 9., inclusive. For lack of information, denies the allegations in subparagraphs B. 6. to 9., inclusive, of paragraph V.

#### VI.

Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination in all respects be approved and the petitioner's appeal denied.

/s/ KENNETH W. GEMMILL,

CWN

Acting Chief Counsel, Internal  
Revenue Service

Of Counsel:

B. H. Neblett, Regional Counsel,

E. C. Crouter, Acting Appellate Counsel,

Edward H. Boyle, Special Attorney,

Internal Revenue Service

[Endorsed]: T.C.U.S. Filed Oct. 13, 1953.

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[Title of Tax Court and Cause.]

## STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that the following facts should be taken as true, without prejudice to the right of either party to introduce other and further evidence not inconsistent therewith.

### I.

Petitioner is a corporation organized and existing under and by virtue of the laws of the State of California, with its principal place of business at 62 Townsend Street, San Francisco, California, and Petitioner is engaged in the business of manufac-

turing, processing, handling and dealing in vegetable oils and vegetable oil raw materials in the United States and elsewhere in the world. As a part of its operations Petitioner purchases copra, the raw material from which coconut oil is manufactured, in the Philippine Islands and sells and ships the same to purchasers elsewhere in the world, chiefly in Europe and Latin-America.

\* \* \* \* \*

#### IV.

Western Vegetable Oils Company, Incorporated, is a corporation organized and existing under and by virtue of the laws of the State of California, with its principal place of business at 24 California Street, San Francisco, California. The corporation was organized in the year 1935 for the purpose of engaging in the vegetable oil business, chiefly in the crushing of copra and other oil bearing materials, the production of coconut oil and other vegetable oils and copra meal and other vegetable oil meals therefrom and the sale of said products in the markets of the United States; the said corporation engaged in said business from its formation to and including March 31, 1954, at which time its copra crushing operations were discontinued due to unfavorable economic conditions in the copra crushing industry.

#### V.

At the beginning of the calendar year 1949 Western Vegetable Oils Company, Incorporated, hereinafter called "Western" had only one (1) class of

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shares of capital stock outstanding, namely 5,182 shares of common stock standing in the names of the following shareholders, in the following amounts and percentages:

Name	No. of Shares	Percentages
Pacific Vegetable Oil Corporation	2,094	40.4091
A. A. Schumann	1,252	24.1605
S. L. Jones & Co. (transferred to W. A. Dow, a shareholder and officer of S. L. Jones & Co. in June 28, 1949)	900	17.3680
R. J. Boomer	250	4.8244
D. S. Burness	178	3.4350
Muriel Burness	178	3.4350
Estate of P. C. Denroche, Deceased	140	2.7016
Thos. A. Allan	140	2.7016
Paul A. Schumann	25	.4824
F. Nelson	25	.4824
Total	5,182	100.0000

## VI.

During the calendar year 1949 and in the month of January, 1950, Western acquired from said shareholders, pursuant to resolutions of the Board of Directors of Western, duly adopted at meetings of said Directors duly called and held, copies of which are attached hereto and made a part hereof, and marked Exhibits 3C through 6F, 3,182 of its shares above listed; that the names of the shareholders, the number of shares acquired from each, the cash per share distributed by Western and the balance of shares thereafter held by each shareholder are as shown in the table below:

Name	No. of Shares Acquired	Date of Acqui- sition	Cash Dis- tributed Per Share	Total Cash Distri- buted	Remaining Shares Held
Estate of P. C.					
Denroche, Dec'd.	140	4/30/49	\$120	\$ 16,200	none
Pacific Vege- table Oil					
Corporation	1,346	10/24/49	220	296,100	748
D. S. Burness	178	11/ 4/49	220	39,160	none
Muriel Burness	178	11/4/49	220	39,160	none
Thos. A. Allan	140	10/24/49	220	30,800	none
Paul A.					
Schumann	25	10/24/49	220	5,500	none
F. Nelson	25	10/24/49	220	5,500	none
W. A. Dow	900	1/ 5/50	220	198,000	none
R. J. Boomer	250	1/10/50	220	55,000	none
A. A. Schumann	0	-----	-----	0	1252

As of December 31, 1948 the book value of said shares was \$220.00 per share. On August 16, 1949 Western declared (and subsequently paid) a dividend of \$10.00 per share to shareholders of record as of August 17, 1949, as shown by resolution of the Board of Directors of Western dated August 16, 1949, attached hereto and marked Exhibit 7G. Attached hereto and marked Exhibit 8H is a table constituting a true and correct summary analysis of the earned surplus account of Western from the commencement of its business to and including December 31, 1950. On or about the 17th day of February, 1950 Petitioner purchased from A. A. Schumann 252 shares of stock held by him in Western at a price of \$220.00 per share, for the purpose of rendering the ownership of Petitioner and A. A. Schumann of the outstanding stock of said corporation equal.

## VII.

Western continued its copra crushing and oil manufacturing activities from the commencement of its business in 1935 until approximately March 31, 1954. The following is a tabulation of the quantities of copra and certain other oil bearing raw materials crushed by Western in each of the years 1942 to 1953, inclusive

Year	Copra Crushed (in pounds)	Other Materials Crushed (in pounds)	
1942	14,239,168	Babassu	12,146,672
		Mustard	
		Seed	1,843,991
		Rice Bran	30,720
		Cohune	78,582
		TOTAL	14,099,965
1943	19,420,504		—0—
1944	27,725,436		—0—
1945	28,504,080		—0—
1946	39,022,794		—0—
1947	53,270,880	Babassu	2,129,576
1948	25,304,012	Babassu	4,680,933
	6,754,070 (Crushed by	Sesame	2,515,955
	32,058,082 others for	TOTAL	7,196,888
	Western acct.)		
1949	38,249,910		—0—
1950	33,875,264	Sesame	2,024,473
1951	47,581,862		—0—
1952	38,907,292		—0—
1953	26,021,450		—0—

Attached hereto and marked Exhibit 9-I are true and correct comparative balance sheets of Western for the calendar years ended December 31, 1948 -



December 31, 1953, inclusive; attached hereto and marked Exhibit 10J are true and correct copies of statements of the net income of Western for said years, as reported by Western on its corporation income and excess profits tax returns for each of said years.

That all plant and equipment owned and maintained by Western prior to the calendar year 1949 continued to be owned and maintained by Western to and including March 31, 1954.

### VIII.

On its income tax return, Form 1120, for the calendar year 1949, Petitioner reported as a dividend the proceeds received from Western upon the acquisition by Western of said 1,346 shares of Western stock above listed, said proceeds being in the amount of \$296,120.00. Offsetting this dividend a credit was claimed for 85% of such dividend resulting in the inclusion of taxable income of the sum of \$44,418.00. Attached hereto marked Exhibit 11K is a photostatic copy of Petitioner's return for said year.

### IX.

Petitioner's basis in said 1,346 shares of Western stock acquired by Western from Petitioner in 1949 was a total of \$18,832.00.

/s/ DUDLEY F. MILLER,

Counsel for Petitioner

/s/ JOHN POTTS BARNES,

Counsel for Respondent

JOINT EXHIBIT No. 3-C

Minutes of Stated Meeting, Board of Directors of  
Western Vegetable Oils Company, Incorporated  
April 27, 1949

Pursuant to the provisions of the By-Laws and notice thereof given to all of the directors, the stated monthly meeting of the Board of Directors of Western Vegetable Oils Company Incorporated was held on April 27, 1949, at the hour of 2:00 o'clock p.m. at the office of the company, 24 California Street, San Francisco, California, having been postponed from April 19, 1949 by consent of all Directors.

There were present the following Directors:

Adolph A. Schumann, Ralph J. Boomer, William A. Dow, Jr., Thos. A. Allan, B. T. Rocca.

Also present: Dudley F. Miller, Secretary of the company.

The minutes of the meeting of March 15, 1949 were read and approved.

The President presented and the Directors examined and discussed the company's balance sheet and income statements for the year to date. The Directors also examined the company's position statements from which it appeared that substantial profits would accrue from operations by the end of June of this year.

The President reported on the proceedings for the appraisal of the company's physical properties, stating that he had not yet received final estimates on the cost of the appraisal.

The President presented to the Directors a letter



which he had received from The Bank of California, N.A., as executor of the estate of Percy C. Denroche, deceased, requesting bids for the purchase from The Bank of California, N.A., as executor, of one hundred forty (140) shares of the stock of this corporation held by the estate. After some discussion the following resolution was moved, seconded and unanimously carried:

Whereas, The Bank of California, N.A., as executor of the estate of Percy C. Denroche, deceased, is the owner of one hundred forty (140) shares of the capital stock of this corporation and, being desirous of selling the same, has requested bids therefor,

Whereas, this corporation has an earned surplus sufficient to enable it to purchase said shares, and it is deemed to be to the best interest of this corporation to offer to purchase said shares,

Now, Therefore, Be It Resolved, that the President of this corporation is hereby authorized to offer to purchase said one hundred forty (140) shares of the capital stock of this corporation from The Bank of California, N.A., as executor of the estate of Percy D. Denroche, deceased, for the sum of One Hundred Twenty Dollars (\$120.00) per share, said offer to be open for acceptance for a period of ten (10) days from the date of this resolution.

There being no further business to come before the meeting, the same on motion duly made and seconded, adjourned.

/s/ Dudley F. Miller,  
Secretary

JOINT EXHIBIT No. 4-D

Minutes of Stated Meeting of Board of Directors of  
Western Vegetable Oils Company Incorporated  
October 18, 1949

Pursuant to the provisions of the By-Laws and notice thereof given to all of the Directors, the stated monthly meeting of the Board of Directors of Western Vegetable Oils Company Incorporated was held on October 18, 1949, at the hour of 2:00 o'clock p.m. at the office of the company, 24 California Street, San Francisco, California.

There were present the following Directors:

Adolph A. Schumann, Ralph J. Boomer, William A. Dow, Jr., Thos. A. Allan.

Also present: Dudley F. Miller, Secretary of the company.

The minutes of the meeting of September 20, 1949 were read and approved.

Mr. B. T. Rocca was not present, being absent on a trip to the Philippine Islands, but B. T. Rocca, Jr. appeared in his stead.

The President gave his report upon the condition of the company's business and presented balance sheets and position statements for the consideration of the Directors.

There was then presented to the meeting an offer from Pacific Vegetable Oil Corporation to sell to the company 1,346 of the shares of this company now owned by Pacific Vegetable Oil Corporation at a price of \$220.00 per share and an offer from Thos. A. Allan, one of the share holders of this

company, offering to sell to this company 140 of the shares of this company, being all of the stock of this company now owned by Thos. A. Allan, at a price of \$220.00 per share.

The Directors discussed these offers and discussed at length whether the financial position of this company would enable it to accept these offers. It appearing that accepting these offers would be to the advantage and best interests of the corporation, and that the financial condition of the corporation enabled it to accept such offers, the following resolution was moved, seconded and unanimously carried:

Whereas, Pacific Vegetable Oil Corporation is the owner of 2,050 shares of the capital stock of this corporation and has offered to sell to this corporation 1,346 of said shares at a price of \$220.00 per share, and

Whereas, Thos. A. Allan is the owner of 140 shares of the capital stock of this corporation and has offered to sell the same to this corporation at the sum of \$220.00 per share, and

Whereas, this corporation has an earned surplus sufficient to enable it to purchase said shares and the Directors of this corporation deem it to be to the best interests of this corporation to purchase said shares so offered,

Now, Therefore, Be It Resolved that the President of this corporation is hereby authorized to accept the offer of Pacific Vegetable Oil Corporation to sell to this corporation 1,346 shares of the capital stock of this corporation and the offer of Thos. A.

Allan to sell to this corporation 140 shares of the capital stock of this corporation at a price of \$220.00 per share, and the President and Secretary of this corporation are hereby authorized to take all steps necessary to consummate the purchase of said shares by this corporation.

The Directors next discussed the question of whether, upon the consummation of such purchase the shares so purchased should be held as Treasury shares or retired. The Secretary called the attention of the directors to the fact that certain other shares of this corporation's stock previously purchased by it at various times were still held as Treasury shares and had not yet been retired, these shares being 698 shares previously purchased from The Bank of California, N.A., as Trustee, under the Will of R. Carl Eddy, Jr., deceased, 140 shares purchased from the Estate of Percy C. Denroche, deceased, and 280 shares purchased from J. H. Thies. After some discussion, the following resolution was unanimously adopted:

Whereas, this corporation has heretofore purchased from The Bank of California, N.A., as Trustee under the Will of R. Carl Eddy, Jr., deceased, 698 shares of its capital stock; from the estate of Percy C. Denroche, 140 shares of its capital stock and from J. H. Thies 280 shares of its capital stock, and

Whereas, all of said shares have heretofore been held by the corporation as Treasury stock, and

Whereas, it appears to be to the advantage and best interest of the corporation that said stock be

retired and the certificates representing said shares cancelled.

Now, Therefore, It Is Hereby Resolved that all of said shares hereinabove mentioned be retired and the certificates representing the same cancelled and the President and the Secretary of this corporation are hereby authorized to take all steps necessary to such retirement and to the cancellation of the certificates representing said shares.

Upon motion duly made, seconded and unanimously carried, the following resolution was adopted:

Whereas, this corporation has accepted the offer of Pacific Vegetable Oil Corporation to sell to this corporation 1,346 shares of its capital stock and the offer of Thos. A. Allan to sell to this corporation 140 shares of its capital stock, and

Whereas, it appears to be to the advantage and best interest that such stock be retired and the certificates representing said shares cancelled upon the consummation of the purchase of said shares.

Now, Therefore, Be It Resolved that upon the consummation of the purchase from Pacific Vegetable Oil Corporation of 1,346 shares of the capital stock of this corporation and the purchase from Thos. A. Allan of 140 shares of the capital stock of this corporation, said shares be retired and the certificates representing said shares cancelled, and the President and the Secretary of this corporation are hereby authorized to take such steps as may be necessary to accomplish said retirement and cancellation.



There being no further business to come before the meeting, the same on motion duly made and seconded, adjourned.

Dudley F. Miller,  
Secretary

JOINT EXHIBIT No. 5-E

Minutes of Special Meeting of Board of Directors  
of Western Vegetable Oils Company Incorporated  
October 26, 1949

Pursuant to the call of the President and by consent of all Directors a special meeting of the Board of Directors of Western Vegetable Oils Company Incorporated was held on Wednesday, October 26, 1949 at the hour of 2:00 o'clock p.m. at the office of the company, 24 California Street, San Francisco, California.

There were present the following Directors:

Adolph A. Schumann, Ralph J. Boomer, William A. Dow, Jr., Thos. A. Allan, B. T. Rocca.

Also present: Dudley F. Miller, Secretary of the company.

The President stated that the purpose of the meeting was to consider certain additional offers from shareholders of the company to sell their stock to the company. He presented to the meeting an offer from Paul A. Schumann to sell to the company twenty-five (25) shares of the stock of this company now owned by him at a price of \$220.00 per share, and an offer from Freda Nelson to sell to

the company twenty five (25) shares of the stock of this company now owned by her at a price of \$220.00 per share. He stated further that he had been informed that Muriel D. Burness and Donald S. Burness intended to offer to sell to this company the shares of the stock of this company now owned by them, amounting to one hundred seventy-eight (178) shares each, at the price of \$220.00 per share, but that such offer had not yet been received by him. He further stated that these offers and prospective offers would cover all of the stock of this company owned by these persons.

The Directors discussed these offers with relation to the financial position of the company. It appeared that the company was in a financial position to accept the offers of Paul A. Schumann and Freda Nelson and would be in a position to accept the offers of Muriel D. Burness and Donald S. Burness if and when made, and it appeared further that it would be further to the advantage and best interests of this corporation to acquire said shares and to accept said offers. In consequence, the following resolution was moved, seconded and unanimously carried:

Whereas, Paul A. Schumann is the owner of twenty-five (25) shares of this corporation and has offered to sell the same to this corporation at the sum of Two Hundred Twenty Dollars (\$220.00) per share, and

Whereas, Freda Nelson is the owner of twenty-five (25) shares of this corporation and has offered to sell the same to this corporation at the sum of

Two Hundred Twenty Dollars (\$220.00) per share, and

Whereas, Muriel D. Burness is the owner of one hundred seventy-eight (178) shares of this corporation, and has indicated that she may offer to sell the same to this corporation at the sum of Two Hundred Twenty Dollars (\$220.00) per share, and

Whereas, Donald S. Burness is the owner of One Hundred Seventy Eight (178) shares of this corporation and has indicated that he may offer to sell the same to this corporation at the sum of Two Hundred Twenty Dollars (\$220.00) per share, and

Whereas, this corporation has an earned surplus sufficient to enable it to purchase said shares and the Directors of this corporation deem it to be to the best interests of this corporation to purchase said shares, and

Whereas, it appears to be to the advantage and best interests of this corporation that said shares of stock be retired when purchased, and the certificates representing said shares cancelled upon the consummation of the purchase of said shares, and

Now, Therefore, Be It Resolved, that the President of this corporation is hereby authorized to accept said offers of Paul A. Schumann and Freda Nelson to sell their said shares of the capital stock of this company at said price of Two Hundred Twenty Dollars (\$220.00) per share and is further authorized to accept any offer received by him from Muriel D. Burness and Donald S. Burness to sell their said shares of the capital stock of this corporation at a price of Two Hundred Twenty Dollars



(\$220.00) per share, and the President and Secretary of this corporation are hereby authorized to take all steps necessary to consummate the purchase of said shares by this corporation, and

Be It Further Resolved that upon the consummation of said purchase said shares so purchased be retired and the certificates representing said shares cancelled, and the President and Secretary of this corporation are hereby authorized to take such steps as may be necessary to accomplish said retirement and cancellation.

There being no further business to come before the meeting, the same on motion duly made and seconded, adjourned.

Dudley F. Miller,  
Secretary

#### JOINT EXHIBIT No. 6-F

Minutes of Special Meeting of Board of Directors  
of Western Vegetable Oils Company Incorporated  
January 4, 1950

Pursuant to the provisions of the By-Laws and notice thereof given to all of the Directors, a special meeting of the Board of Directors of Western Vegetable Oils Company Incorporated was held on Wednesday, January 4, 1950 at the hour of 2:00 o'clock P.M. at the office of the company, 24 California Street, San Francisco, California.

There were present the following Directors:

Adolph A. Schumann  
Ralph J. Boomer

William A. Dow, Jr.

Thos. A. Allan

B. T. Rocca

Also present: Dudley F. Miller, Secretary of the company.

The President stated that the purpose of the meeting was to consider an offer which he had received from William A. Dow, Jr. to sell to this corporation all of the stock owned by him in this corporation amounting to 900 shares at the same price at which the other share holders had previously offered their shares to the corporation, namely \$220.00 per share. Mr. Dow stated that he desired to dispose of his shareholding in this corporation so as to concentrate his attention upon the operation of S. L. Jones & Co. The Directors discussed this offer and examined the financial position of the company with respect to the acceptance of the offer. In the course of this discussion Mr. Boomer stated that it was his desire to offer to sell the shares of stock owned by him in this company in the amount of 250 shares at the same price, although he had not yet formally offered such stock to the corporation.

After an extended discussion the Directors concluded that the corporation was in the financial position to purchase said shares and that it would be to the advantage and best interests of the corporation to do so. Thereupon on motion duly made, seconded and unanimously carried, the following resolution was adopted:

Whereas, William A. Dow, Jr. is the owner of 900 shares of this corporation and has offered to sell the same to this corporation at the sum of \$220.00 per share, and

Whereas, Ralph J. Boomer is the owner of 250 shares of this corporation and has indicated that he intends to offer to sell the same to this corporation at the sum of \$220.00 per share, and

Whereas, this corporation has an earned surplus sufficient to enable it to purchase said shares and the Directors of this corporation deem it to be to the advantage and best interests of this corporation to purchase said shares, and

Whereas, it appears to be to the advantage and best interests of this corporation that said shares of stock be retired when purchased and the certificates representing said shares cancelled upon the consummation of the purchase of said shares,

Now, Therefore, Be It Resolved that the President of this corporation is hereby authorized to accept said offer of William A. Dow, Jr. to sell to this corporation his said shares of the capital stock of this corporation at said price of \$220.00 per share and he is further authorized to accept any offer made by Ralph J. Boomer to sell his said shares of the capital stock of this corporation at a price of \$220.00 per share, and the President and Secretary of this corporation are hereby authorized to take all steps necessary to consum-

mate the purchase of said shares by this corporation, and

Be It Further Resolved that upon the consummation of said purchase said shares so purchased be retired and the certificates representing said shares cancelled, and the President and Secretary of this corporation are hereby authorized to take such steps as may be necessary to accomplish said retirement and cancellation.

There being no further business to come before the meeting, the same on motion duly made and seconded, adjourned.

Dudley F. Miller  
Secretary

# JOINT EXHIBIT No. 7-G

Minutes of Stated Meeting of Board of Directors of  
Western Vegetable Oils Company Incorporated  
August 16, 1949

Pursuant to the provisions of the By-Laws and notice thereof given to all of the Directors, the stated monthly meeting of the Board of Directors of Western Vegetable Oils Company Incorporated was held on August 16, 1949, at the hour of 2:00 o'clock P.M. at the office of the company, 24 California Street, San Francisco, California.

There were present the following Directors:

Thos. A. Allan  
Adolph A. Schumann

Ralph J. Boomer

William A. Dow, Jr.

B. T. Rocca

Also present: Dudley F. Miller, Secretary of the company.

The minutes of the meeting of July 19, 1949 were read and approved.

The President reported upon the company's financial position for the year and for the month ending July 31st. His report was examined and discussed by the Directors. The President stated that the profit position for July should be continued into August.

The Secretary reported upon the status of the dispute between this company and Southern Pacific Company over demurrage charges on copra cars, reporting that a formal complaint had been filed with the I.C.C. seeking a review of the correctness of the charges made by the Southern Pacific Company.

The Directors then discussed the matter of dividends. It appearing the company had sufficient net earnings at this time to warrant the payment of a dividend, the following resolution was unanimously adopted:

Whereas, the company at this time has net earnings and profits sufficient to pay a cash dividend of Ten Dollars (\$10.00) per share on the shares of the company now issued and outstanding, and

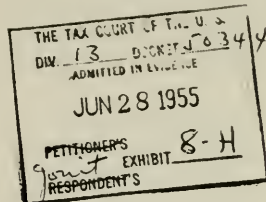
Whereas, it is the desire of this company that such dividend be paid,

Now, Therefore, Be It Resolved that a dividend of Ten Dollars (\$10.00) per share is hereby declared upon the shares of this company now issued and outstanding, said dividend to be payable to shareholders of record as of August 17, 1949.

There being no further business to come before the meeting, the same on motion duly made and seconded, adjourned.

Dudley F. Miller  
Secretary





WESTERN VEGETABLE OILS COMPANY, INCORPORATED

SUMMARY ANALYSIS OF EARNED SURPLUS

	<u>Income or</u>	<u>Taxes on</u>	<u>Deductions</u>	<u>Other</u>	<u>Increase or</u>
	<u>(Loss)</u>	<u>Income</u>	<u>Dividends</u>	<u>Adjustments</u>	<u>(Decrease)</u>
					<u>Earned</u>
					<u>Surplus</u>
1935	\$ 9,427.84	\$ -	\$ -	\$ -	\$ 9,427.84
1936	75,074.59	1,215.08	69,300.00	-	4,559.51
1937	(49,602.88)	3,848.57	6,300.00	-	(59,751.45)
1938	(33,401.40)	-	-	(360.00)	(33,041.40)
1939	27,745.44	-	-	835.75	26,909.69
1940	(3,275.39)	4,522.34	-	(3,678.80)	(4,118.93)
1941	113,400.95	53,159.42	-	4,620.00	55,621.53
1942	26,024.20	6,962.93	-	-	19,061.27
1943	51,119.43	450.00	39,060.00	-	11,609.43
1944	65,152.50	38,596.21	11,760.00	15,168.85	(372.56)
1945	75,656.05	44,020.86	10,364.00	-	21,271.19
<b>Totals</b>	<b>\$ 357,321.33</b>	<b>\$ 152,775.41</b>	<b>\$ 136,784.00</b>	<b>\$ 16,585.80</b>	<b>\$ 51,176.12</b>
1946	344,858.23	137,115.08	51,820.00	-	✓ 155,923.15
1947	1,069,837.49	407,179.51	103,640.00	913.42	✓ 558,104.56
1948	88,415.66	33,658.07	51,820.00	(158.22)	✓ 3,095.81
			50,420.00)		
1949	366,416.03	143,445.99(1)	433,040.00) ?	4,052.88	✓ 264,542.84)
1950	(121,092.71)	348.16(2)	253,000.00	-	✓ 1374,440.87)
<b>Totals</b>	<b>\$ 2,105,756.03</b>	<b>\$ 874,522.22</b>	<b>\$ 1,080,524.00</b>	<b>\$ 21,393.88</b>	<b>\$ 129,315.93</b>

(1) Amount paid in acquisition of 2,032 shares of stock charged to earned surplus.

(2) Amount paid in acquisition of 1,150 shares of stock charged to earned surplus.





# WESTERN VEGETABLE OILS CO., INC.

THE TAX COURT OF THE U. S.  
DIV. 13 DOCKET 56344  
ADMITTED IN EXCELLENCE

JUN 28 1955

PETITIONER'S  
EXHIBIT  
RESPONDENT'S

## COMPARATIVE BALANCE SHEETS FOR THE YEARS ENDED

DECEMBER 31, 1948 TO 1953, INCLUSIVE

### A S S E T S

	1948	1949	1950	1951	1952	1953
Cash	\$448,201.72	\$ 238,503.21	\$ 54,739.69	\$ 84,466.05	\$ 54,005.10	\$ 48,277.30
Notes and accounts receivable	94,136.61	351,821.28	46,315.00	149,985.35	193,387.33	224,172.57
Inventories	324,181.27	125,764.77	118,192.98	451,233.11	292,035.67	144,072.53
Depreciable assets	189,071.24	207,168.51	207,674.60	210,458.90	262,257.54	281,602.66
Reserve for depreciation	(102,398.28)	(118,663.84)	(134,373.24)	(144,177.03)	(165,835.27)	(185,568.43)
Land					15,000.00	15,000.00
Other assets	14,866.72	16,033.31	17,085.30	5,571.85	27,133.63	7,414.89
Corpa advances		294,000.00				
	\$968,059.28	\$1,114,627.24	\$309,634.33	\$757,538.23	\$677,984.00	\$534,971.52

### L I A B I L I T I E S

Accounts payable	\$ 31,960.16	\$ 341,196.43	\$ 45,786.83	\$342,179.20	\$ 94,261.66	\$ 52,013.26
Notes payable					246,700.00	204,500.00
Accrued expenses	2,751.41	1,934.42	3,141.57	2,467.67	6,908.52	4,213.54
Accrued Federal income taxes	33,658.07	136,349.59		48,277.65		
Capital stock	62,300.00	62,300.00	62,300.00	62,300.00	63,000.00	63,000.00
Paid-in surplus	69,090.00	69,090.00	69,090.00	69,090.00	68,390.00	68,390.00
Earned surplus	768,239.64	503,750.80	129,315.93	233,223.71	198,723.82	142,854.72
	\$968,059.28	\$1,114,627.24	\$309,634.33	\$757,538.23	\$677,984.00	\$534,971.52



DIV 72  
 JUN 25 1955  
 RECEIVED  
 10-10-11  
 10-10-11

WESTERN VEGETABLE OILS CO., INC.

STATEMENTS OF NET INCOME FOR THE YEARS ENDED DECEMBER 31, 1948 TO 1953, INCLUSIVE,  
AS REPORTED ON CORPORATION INCOME AND EXCESS PROFITS TAX RETURNS

	1948	1949	1950	1951	1952	1953
<u>INCOME</u>						
Gross sales	\$ 5,617,486.61	\$ 4,672,596.09	\$ 5,373,894.78	\$ 6,551,529.94	\$ 5,601,159.15	\$ 6,104,542.20
Cost of goods sold	5,402,829.72	4,205,108.39	6,385,724.51	6,350,919.12	5,495,309.13	6,042,542.20
Gross profit (loss)	\$ 214,656.89	\$ 467,487.70	\$ (11,829.73)	\$ 200,610.82	\$ 105,790.02	\$ 121,999.99
Interest income	170.64	257.73	44.47	258.53	722.94	2,111.11
Other income	38,054.86	7,634.56	6,232.51	142.07	19,815.39	2,957.45
Gain on sale of property						( )
Total income	\$ 252,882.39	\$ 475,380.09	\$ (5,552.75)	\$ 201,011.42	\$ 189,205.80	\$ 1,170.55
<u>DEDUCTIONS</u>						
Compensation of officers	\$ 24,200.00	\$ 29,200.00	\$ 22,200.00	\$ 22,200.00	\$ 30,000.00	\$ 30,000.00
Salaries and wages	9,291.87	8,439.90	8,350.00	10,008.00	43,251.24	43,251.24
Rent	2,040.00	2,040.00	1,870.00	2,040.00	5,704.47	5,704.47
Repairs	60.25				13,411.11	13,411.11
Interest	5,297.55	2,292.41	8,826.59	5,005.09	16,122.49	16,122.49
Taxes	41,056.87	8,857.62	19,044.16	5,950.25	21,000.00	21,000.00
Contributions	625.00	625.00	629.00	631.00	21,000.00	21,000.00
Depreciation	19,335.88	21,511.20	19,006.92	19,614.71	1,572.45	1,572.45
Bad debts					50,537.21	50,537.21
Advertising	62,401.09	43,902.25	35,301.45	28,204.47	221,891.11	221,891.11
Other deductions						
Total deductions	\$ 104,308.51	\$ 116,665.38	\$ 115,008.12	\$ 94,573.52	\$ 221,891.11	\$ 221,891.11
Net taxable income (loss)	\$ 88,573.88	\$ 358,714.71	\$ (121,440.87)	\$ 106,437.90	\$ (32,685.31)	\$ (10,720.56)



UNITED STATES  
CORPORATION INCOME TAX RETURN  
For Calendar Year 1949

1949

or fiscal year beginning 1949, and ending 1950

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

PACIFIC VEGETABLE OIL CORPORATION

62 TOWNSEND STREET

SAN FRANCISCO, CALIFORNIA

(City or town, postal zone number)

CALIFORNIA

(State)

Date incorporated 1-1-35 State or country CALIFORNIA

Principal business activity (See Instruction N) VEGETABLE OIL PROCESSING

Business gross code number 288  
(From Instruction N)

Number of places of business

NET INCOME COMPUTATION

GROSS INCOME				
1. Gross sales (where inventories are an income-determining factor)	\$	Less: Returns and allowances	\$	59,705,495 19
2. Less: Cost of goods sold. (From Schedule A)				58,315,900 45
3. Gross profit from sales				1,389,594 74
4. Gross receipts (where inventories are not an income-determining factor)	\$			
5. Less: Cost of operations. (From Schedule B)				
6. Gross profit where inventories are not an income-determining factor				62,559 32
7. Interest on loans, notes, mortgages, bonds, bank deposits, etc.	\$	Less: Premiums paid	\$	
8. Interest on corporation bonds, etc.	\$			
9. (a) Interest on United States savings bonds and Treasury bonds owned in excess of the official amount of \$5,000 issued prior to March 1, 1941. (b) Interest on obligations of certain instrumentalities of the United States issued prior to March 1, 1941. (c) Interest on Treasury notes issued on or after December 1, 1941, and obligations issued on or after March 1, 1941, by the United States or any agency or instrumentality thereof.				2,840 00
10. Rents				
11. Royalties				
12. (a) Total net short-term capital gain (or excess of net short-term capital gain over net long-term capital loss). (From Schedule C)				
(b) Total net long-term capital gain (or excess of net long-term capital gain over net short-term capital loss). (From Schedule C)				(2,751 39)
(c) Net gain (or loss) from sale or exchange of property other than capital assets. (From Schedule D)				317,060 00
13. Dividends. (From Schedule E)				310,311 27
14. Other income. (State nature)				Schedule attached
15. Total income in items 3 and 6 to 14, inclusive				2,075,943 94
DEDUCTIONS				
16. Compensation of officers. (From Schedule F)	\$			34,810 71
17. Salaries and wages (not deducted elsewhere)				175,957 68
18. Rent				
19. Repairs				2,248 50
20. Bad debts. (From Schedule G)				132,538 42
21. Interest				148,337 15
22. Taxes. (From Schedule H)				111,546 61
23. Contributions or gifts paid. (From Schedule I)				1,703 40
24. Losses by fire, storm, shipwreck, or other casualty, or theft. (Submitt schedule)				
25. Depreciation. (From Schedule J)				77,144 93
26. Depletion of mines, oil and gas wells, timber, etc. (Submitt schedule)				
27. Amortization of emergency facilities. (Submitt schedule)				
28. Advertising				3,341 46
29. Amounts contributed under a pension, annuity, stock bonus, or profit-sharing plan, etc.				14,362 42
30. Other deductions authorized by law. (From Schedule K)				941,224 75
31. Total deductions in items 16 to 30, inclusive				1,700,033 03
32. Net income before net operating loss deduction on account of net operating loss carry-over (item 15 less item 31)				\$ 375,910 91
33. Less: Net operating loss deduction on account of net operating loss carry-over from two preceding years. (Submitt statement)				
34. Net income				\$ 375,910 91
TOTAL INCOME TAX				
35. Total income tax (line 13, page 3)	\$			40,435 77
36. Less: Credit for income taxes paid to a foreign country or United States possession allowed a domestic corporation				
37. Balance of income tax due				40,435 77

DECLARATION. (See Instruction E)

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, each for himself declare under the penalties of perjury that this return (including any accompanying schedules and statements) has been examined by him and is, to the best of his knowledge and belief, a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Internal Revenue Code and the regulations issued thereunder.

H. V. Roca, President  
(President or other principal officer) (State title)

Arthur Andersen & Co., Treasurer  
(Treasurer, Assistant Treasurer or Chief Accounting Officer) (State title)

CORPORATE SEAL

DECLARATION. (See Instruction E)

I/we declare under the penalties of perjury that I/we prepared this return for the person named herein and that the return (including any accompanying schedules and statements) is a true, correct, and complete statement of all the information respecting the tax liability of the person for whom this return has been prepared of which I/we have any knowledge.

(Signature of person preparing the return)

Harrison V. Roca

(Signature of person preparing the return)

Arthur Andersen & Co.

EXHIBIT II-K





1. Kind of Property of buildings, and material of which constructed	2. Date Acquired	3. Cost or Other (Do not include land or value property)	4. Annual Payment (Do not include interest on debt)	5. Depreciation Allowance (See instructions)	6. Depreciation Cost (See instructions)	7. Total (Sum of lines 1 through 6)	8. Total (Sum of lines 1 through 6)	9. Depreciation Allowance (See instructions)
Schedule attached								
Total. (Enter as item 24, page 1)								

#### Schedule K—OTHER DEDUCTIONS. (See Instruction 30)

Schedule Attached

### TAX COMPUTATION. (See Tax Computation Instructions)

NORMAL TAX COMPUTATION			
1. Net income (Item 24, page 1)		\$ 375,910	91
2. Less: Interest on certain obligations of the United States and its instrumentalities issued prior to March 1, 1941. (Enter total of Items 9 (a) and (b), page 1)		-	
3. Adjusted net income		\$ 375,910	91
4. Less: Dividends received credit (85 percent of column 2, Schedule K, but not in excess of 85 percent of line 3, above)		269,501	00
5. Normal-tax net income		\$ 106,409	91
6. Normal tax. If amount on line 5 is:			
Not over \$5,000; enter 15 percent of line 5			
Over \$5,000 but not over \$50,000; enter \$750, plus 17 percent of excess over \$5,000			
Over \$50,000 but not over \$25,000; enter \$3,300, plus 19 percent of excess over \$50,000			
Over \$25,000 but not over \$50,000; enter \$4,350, plus 31 percent of excess over \$25,000			
Over \$50,000; enter 24 percent of amount on line 5			
		\$ 25,538	38

NOTE.—The normal tax of foreign corporations engaged in trade or business within the United States is 24 percent of normal-tax net income, irrespective of the amount.

SURTAX COMPUTATION			
7. Net income (line 1, above)		\$ 375,910	91
8. Less: Dividends received credit (85 percent of column 2, Schedule K, but not in excess of 85 percent of line 3 above, excluding from the computation certain dividends received on preferred stock of a public utility)		\$ 269,501	00
9. Dividends paid on certain preferred stock if taxpayer is a public utility		269,501	00
10. Surtax net income		\$ 106,409	91
11. Surtax. If amount on line 10 is:			
Not over \$25,000; enter 6 percent of line 10 (6 percent in case of a consolidated return)			
Over \$25,000 but not over \$50,000; enter \$1,500, plus 22 percent of excess over \$25,000 (\$2,000 plus 24 percent of excess over \$25,000 in case of a consolidated return)			
Over \$50,000; enter 14 percent of amount on line 10 (16 percent in case of a consolidated return)			
		\$ 14,897	59
12. Total normal tax and surtax (line 8 plus line 11)		\$ 40,435	77
13. Total tax (line 12, or line 28 of Schedule C)		\$ 40,435	77

### QUESTIONS

- If this is the corporation's first return, indicate whether (a) completely new business ☐, or (b) successor to previously existing business, which was organized as (1) corporation ☐, (2) partnership ☐, or (3) sole proprietorship ☐, or (4) other (indicate) \_\_\_\_\_. If successor to previously existing business, give name and address of the previous business organization \_\_\_\_\_.
- Collector's office where the corporation's return for the preceding year was filed San Francisco.
- Enter amount of income (or deficit) from Item 32, page 1, Form 1120 for 1943 \$1,101,544.19.
- The corporation's books are in care of Corporation. Located at 62 Townsend St., San Francisco.
- Enter the approximate number of stockholders at the close of the taxable year 75.
- Check if the corporation is a farmers' marketing or a farmers' purchasing cooperative association ☐, a chambers' cooperative association ☐, or other cooperative association ☐.
- Is the corporation a personal holding company within the meaning of section 501 of the Internal Revenue Code? No. (If so, an additional return must be filed.)
- Is this a consolidated return? No. (If so, procure from the collector of internal revenue for your district Form 951, Affiliations Schedule, which shall be filed in and filed as a part of this return.)
- If this is not a consolidated return: (a) Did the corporation own at any time during the taxable year 50 percent or more of the voting stock of another corporation either domestic or foreign? Yes; or (b) did any corporation, individual, partnership, trust, or association own at any time during the taxable year 50 percent or more of the corporation's voting stock? No. (If either answer is "yes," attach separate schedule showing: (1) Name and address; (2) percentage of stock owned; (3) date stock was acquired; and (4) the collector's office in which the income tax return of such corporation, individual, partnership, trust, or association for the last taxable year was filed.)
- Is this return made on the basis of cash receipts and disbursements? No. If not, describe fully in separate statement. Accrual.
- State whether the inventoried at the beginning and end of the taxable year were valued at cost, or cost or market, whichever is lower. Lower of cost or market, except for 100 shares of first-cut basis. If other basis is used, explain fully in separate statement, giving date inventory was last reconciled with stock (see Specific Instruction 2). Which are on last-in, first-out basis.
- Did the corporation make a return of information on Forms 1066 and 1069 or Form W-2a for the calendar year 1943 (see instruction G-1)? Yes.
- Has any transaction described in Instruction G-2 occurred on or after October 5, 1940? (Answer "yes" or "no") No.
- Did the corporation at any time during the taxable year own directly or indirectly any stock of a foreign corporation? No. (If so, attach



[Title of Tax Court and Cause.]

REPORTER'S TRANSCRIPT

Customs Courtroom 421, Appraiser's Building,  
630 Sansome Street, San Francisco, California,  
Tuesday, June 28, 1955.

(Met pursuant to notice.)

Before Honorable Marion J. Harron, Judge.

Appearances: Dudley F. Miller, Esq., 400 Montgomery Street, San Francisco, California, appearing for the Petitioner. Edward H. Boyle, Esq., (Honorable John Potts Barnes, Chief Counsel, Bureau of Internal Revenue), appearing for the Respondent. [1]\*

The Clerk: Docket No. 50344, Pacific Vegetable Oil Corporation.

Mr. Miller: Dudley F. Miller appearing for the Petitioner.

Mr. Boyle: Edward H. Boyle for the Respondent.

The Court: Mr. Miller, I understand all the facts are stipulated. Are you going to offer the stipulation, or will Mr. Boyle?

Mr. Miller: Mr. Boyle and I have signed the stipulation, and I would like to offer the original at this time, with all exhibits attached and a duplicate without exhibits.

The Court: How many exhibits are there?

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\* Page numbers appearing at top of page of original Reporter's Transcript of Record.

Mr. Miller: Eleven, and they are numbered both numerically and alphabetically because they are joint exhibits.

The Court: Could you, on that original copy, just pull off the exhibits from the stipulation? I know they are referred to in the stipulation, but I will detach them and have them marked as exhibits for our convenience in working on the case.

Mr. Miller: Would you like to have them detached now?

The Court: Would you please?

The stipulation is received and made part of the record. There are exhibits attached to [2] the stipulation, and it is always a good procedure when we have time to ask counsel to say something about these exhibits. You know the interval of time that is required for one new mind, fresh on the subject, to absorb what other minds have taken a good deal of time to understand, and even though you intend to make all of these matters clear in your briefs, why, there is lacking when we read briefs that personal contact we can have with counsel when the case is presented.

Since there will be no testimony taken in the case, and we have a quiet courtroom, I thought we could use a little time to learn directly from counsel their respective views about these exhibits.

I see that the question relates to the propriety of a deduction of \$159,256.18 in 1949, in an account designated "Reserve for out-turn settlements," which account applies exclusively to contracts covering trans-copra shipments.



I take it that is the main issue in the case, and it appears as though we have one of the accounting problems in this case. Then there are some other issues presented. I take it the petitioner manufactured or processed vegetable oils; is that right?

Mr. Miller: That is right.

The Court: And it imports raw materials?

Mr. Miller: That is right.

The Court: From which it makes cocoanut [3] oil and other oils?

Mr. Miller: I would like to state to your Honor that the two issues are really of equal importance from the standpoint of the tax dollars involved.

The \$148,000 deficiency which appears in the petition is stated in the petition actually to involve only 112, due to the fact that there were about \$35,000 of admitted adjustments in the year, resulting primarily from adjustments for loss in first-out inventory to determine the issues and things of that character, so that the amount actually involved here in terms of deficiency is approximately \$112,000.

The first issue, which you have correctly stated, is an accounting issue almost exclusively. The second issue is an issue of the nature of which your Honor is undoubtedly familiar; the handling or treatment of inter-corporate stock actions as dividends or as capital gain.

Those two issues are in fact quite distinct because they are only related in the taxable way and taxpayer was in the same kind of business.



The Court: You go ahead and state what your position is under each of these issues. [4]

\* \* \* \* \*

The Court: Now, Mr. Miller, what is the [47] next issue that we have to take up?

### Opening Statement on Behalf of the Petitioner

Mr. Miller: The next issue is the issue which is entirely distinct from this one, the issue of the treatment of the purchase price, from the Petitioner's point of view, from the sales price of stock held in another corporation as dividend income as distinguished from capital gains income.

I would like to, with the Court's indulgence, make a one sentence statement with respect to the other issue before I pass to this. Our contention will be, and is, that what Petitioner did in connection with this so-called change of accounting practice was simply to follow the true accrual method of accounting more accurately than it had been doing before, and not to make a change in method at all.

That will be our contention, based, of course, upon the contention that when the cargo is shipped, all that we know we can get, all we know we are entitled to, is 95%. Whether we are entitled to more or whether we are required to make a refund to the purchaser is not at that time known, and therefore, not in our view accruable items.

The Court: Your point is that it was an error to accrue the 400% of the invoice price?

Mr. Miller: Yes.

The Court: For how many years had the taxpayer been doing that before 1949? [48]

Mr. Miller: I am sorry to say that I can't answer that positively, but I think for a considerable number of years, so far as I know, that had been the practice during the years subsequent to the end of the war.

The taxpayer was not extensively purely in the marketing side of copra prior to the war. It was at the end of the war when the Philippines were liberated that this business began in volume for the Petitioner.

The other issue, as I say, is one entirely distinct. In the stipulation of facts, the facts begin with Paragraph 4 and run on through to the end of the stipulation.

The first exhibit is not precisely an exhibit, but rather a tabulation which appears in Paragraph 5 of the statement of facts.

As background, the situation was this: Western Vegetable Oils Company, Inc., is another company which was in the copra business exclusively, or virtually exclusively from 1935 on until very recently; at the time that these transactions occurred in 1949, it was heavily engaged in the business.

At that time, the beginning of 1949, Paragraph 5 shows the shareholdings in the company, showing the Petitioner with somewhat in excess of 2,000 shares out of somewhat in excess of 5,000 shares of stock outstanding, representing 40% of stock in the company.

The other shareholders are likewise listed. [49]

In the course of 1949, particularly beginning with October, 1949, and from then until January 10, 1952, Western bought the shares of all of its shareholders in some degree or other except one. That tabulation is shown on page six. It purchased a portion of the shares owned by the Petitioner and all of the shares owned by all of its other shareholders except Mr. Scheumann, who is president of the company.

The paragraph continues to give further statistical data with respect to Western; namely, the book value of the shares during that period of time, which was \$220.

The Court: You have some exhibits here, 3-C to 8-F, which relate to the acquisition by Western?

Mr. Miller: I beg pardon: I was looking for that on the next page.

The Court: Western acquired from its shareholders some of its outstanding stock. What were the terms on which Western acquired some of the outstanding stocks from the stockholders?

Mr. Miller: Those terms were shown in those exhibits, your Honor.

The Court: Do you remember roughly what they were? Did they acquire them at the market price? Did the stock have a par value?

Mr. Miller: No.

The Court: What did they pay? [50]

Mr. Miller: Book value, \$220 per share.

The Court: As of December 31, 1948?

Mr. Miller: That is right. Those exhibits listed,

3-C to 6-F are the minutes, corporate minutes in which the stock——

The Court: We can go through this rather quickly. This is easy to grasp. Then later Western paid, or declared a dividend in 1949 of \$10 per share?

Mr. Miller: On August 16.

The Court: And distributed that.

Mr. Miller: And that is shown by an exhibit.

The Court: And what did the Commissioner determine with respect to this? In other words, the Petitioner received some money?

Mr. Miller: Yes.

The Court: From Western in 1949. How much did the Petitioner receive from Western in 1949?

Mr. Miller: The Petitioner received \$296,000.

The Court: And did it get \$296,000 for the stock it surrendered to Western?

Mr. Miller: Yes.

The Court: How much stock did it surrender?

Mr. Miller: 1,346 shares.

The Court: And at \$220 per share?

Mr. Miller: Yes. [51]

The Court: What did the Commissioner determine? How did the taxpayer first handle that in his return?

Mr. Miller: The taxpayer reported that in its return as dividend income.

The Court: Reported as dividend 296,000?

Mr. Miller: Yes.

The Court: Why?

Mr. Miller: And the Commissioner insisted upon a capital gains.

The Court: Isn't that unusual?

Mr. Miller: We didn't think so.

The Court: Didn't this entire affair have a basis for that?

Mr. Miller: Yes.

The Court: What was the basis?

Mr. Miller: I believe it was \$18,000—some.

The Court: How long has the Petitioner owned that stock?

Mr. Miller: For various years, beginning with 1935. It had acquired its total holdings of 2,096 over a period of time.

The Court: Well, Western was controlled by the Petitioner?

Mr. Miller: Yes.

The Court: It had 40% of the outstanding [52] stock, and a Scheumann had 24% of the outstanding stock; that takes care of 64, and S. L. Jones & Company had 17%. Now, those three were the largest stockholders?

Mr. Miller: Yes.

The Court: Other stockholders had stock ranging from 2 to 4%?

Mr. Miller: Yes.

The Court: Who was Scheumann?

Mr. Miller: Mr. Scheumann was president of Western.

The Court: Was he an officer of Petitioner?

Mr. Miller: At that time he was a director of Petitioner, I believe.



The Court: Why did the taxpayer report what it received from surrender of its stock? What is your theory now underlying your contention that the distribution is one of dividend?

Mr. Miller: Our theory is that these distributions, and in particular, of course, the distribution made of Petitioner has the net effect of a dividend.

The Court: Why? You are just stating your conclusions. You aren't stating your theory.

Mr. Miller: Well, I am sorry. I thought you meant what our position was.

The Court: No; why did you take that position?

Mr. Miller: Our theory is, as is again [53] illustrated in the exhibits and other statements, that Western had, at the time these distributions were made, very substantial earned surplus, accumulated over the years.

The Court: Is that shown in your stipulation?

Mr. Miller: Yes, it is. I will refer to that exhibit. Statement of earned surplus is——

The Court: Are you going on the definition that any distribution out of, any distribution of dividends out of earnings?

Mr. Miller: No; we are going upon the basis that, first, due to the fact that Petitioner retains substantial shareholdings; secondly, that Western had very substantial earned surplus, very substantial cash reserves at that time, built up over the years, made this distribution, and the others, thereby distributing earned surplus, did not contract itself in its business, or change its business in any way as, again, we believe——



The Court: You are taking an awful lot of time, Mr. Miller, if you will excuse me, to get down to a point of some kind under some tax decisions. Have we held that where all stockholders turn in their stock in exactly the same proportion that there is no change at all, some result in that distribution?

That has to do with tax free reorganization. I don't see what your point is here. Ordinarily, when stock is [54] surrendered, the corporation capital account is reduced. There is no longer a certain amount of outstanding stock and a reduction of the capital account must mean a return of capital to stockholders, and if it gets any more basis under that capital, he realizes capital gains.

Offhand, it would seem that the Respondent's determination was a normal, usual determination and that the taxpayer's position was abnormal.

Mr. Miller: I think the position of the Commissioner is a position which he quite often takes when he will get a little more tax that way, but in this case, he gets less because of the application of the 85% credit; without that, of course, the Commissioner would collect more dollars, more than he would with the other.

We are relying upon our interpretation of Section 115(g).

The Court: What cases are you relying on?

Mr. Miller: We are relying on, among others, Boyle vs. Commissioner. We will be——

The Court: What citation?

Mr. Miller: 187 Fed. 2, 557. Upon Flanagan vs. Halvering, 116 Fed. 2, 937; Fostoria Glass Com-

pany vs. York in 45 Fed. Supplement 962; on United National Corporation, 2 Tax Court 111, and upon Pullman, Inc. vs. Commissioner, 8 Tax Court 292, and upon Forhan vs. Commissioner in 75 Fed. 2, 268; and [55] Reihnstram, 125 Fed. 2d., 790.

There are one or two others as well. Carter Tiffany, 16 Tax Court, 176. In fact, the Boyle and Tiffany cases are a different side of the shield. And Vassely vs. Commissioner in 331, U.S. 737.

The Court: I suppose that is about all you need to go into on that, isn't it? You have the facts stipulated.

Mr. Miller: I think so, yes.

The Court: Mr. Boyle, do you want to say anything about that?

Mr. Miller: May I add one thing? As far as the exhibits go, Exhibit 9-I and 10-J are statements, are comparative balance sheets, statements of income for Western again showing factual bases or what we conceive to be a factual basis for our contention.

The Court: Mr. Boyle?

Opening Statement on Behalf of the Respondent.

Mr. Boyle: The Commissioner's position is that on the form of this there was a partial liquidation; they were dealing at arm's length. The assets were reduced approximately 60%. The working capital was practically eliminated; 7 of the 9 stockholders were completely eliminated. There was no rateable distribution.

Normally, 115-C would apply. Of course, the Commissioner can look to substance over form. In

this case the [56] position is turned. The taxpayer is ignoring the form and saying that the substance of it is a distribution in the nature of a dividend, since it is the equivalent to a dividend. Of course, he has the burden of showing the unusual circumstances that make that so.

115-G normally is a loophole provision; it is to prevent partial distribution, or prevent the argument that dividends are actually partial distributions, to prevent the guise of a partial distribution.

The Court: Prevent a distribution of dividends under the guise of a partial liquidation, is that what you are trying to say?

Mr. Boyle: That is a much better way of saying it; that is true. Of course, here the taxpayer is using that same provision and the Commissioner doesn't believe that it is established under the facts of this particular distribution, that these were dividends.

The Court: What cases are you going to rely on, do you know yet?

Mr. Boyle: Well, going back to some old ones; Salt Lake Hardware, 27 BTA 482; Palmetto, 30 BTA, 544; Pullman, Inc. vs. Commissioner, 2 TC 292.

Of course, it is submitted that the facts of each particular case will determine this issue. In fact, that is even more important than the intent, or the motives as in the [57] case of Flanagan vs. Halvering, which the Petitioner has cited, it was held that the net effect of the distribution rather than the moves or motives of the taxpayer or its corporation

is the fundamental question in administering Section 115-G.

The Court: Are you really in agreement on the facts under this, or are you going to ask the Court to interpret your exhibits and draw conclusions from them, and in that way resolve some differences of opinion between you as to what the facts are?

Mr. Boyle: Well, the only fact that we concede that was not put in, your Honor——

The Court: That doesn't answer my question now.

Mr. Boyle: Yes; the answer to that is in the affirmative. We are asking you to pass upon it as submitted.

The Court: I am not sure you understand this. Supposing you had not stipulated your facts on this? Supposing you had agreed that there could be received in evidence without the formalities of identification and all of that, certain statements showing the financial position of Western, and so forth, but the issue was going to be tried, the taxpayer would call a witness to the stand and he would ask the witness why this distribution was made, why Western wanted to acquire a certain amount of the outstanding stock, why did they adopt a resolution at that time, a resolution that doesn't say very [58] much but it gives you the net result of a decision; a proposal is made, a resolution is proposed, and adopted, and you don't get very much of the real background of the situation from reading a corporate resolution.

You look at the balance sheet of a corporation

and it shows you what your surplus is, what the capital is, and so forth. Well, what do you want me to do with this issue? You come in and say you have stipulated the facts, and Mr. Boyle tells the Court that intent is important here; it is a fact. If you were agreed upon the facts, you wouldn't have a question before the Court to decide, would you?

Mr. Boyle: We might very well have a question, yes.

The Court: Why?

Mr. Boyle: What is the law under those facts, or pursuant to those facts?

The Court: Where do you differ in your views about what the facts are?

Mr. Boyle: Of course, the Commissioner comes here, maybe relying erroneously on his *prima facie* case. The burden is on the Petitioner to overcome the normal presumptions of 115-C and G, and certainly the possibility of having corporate officers testify has been discussed.

The Petitioner apparently doesn't feel it necessary and the Respondent doesn't wish to broaden the record beyond what is permissible under the circumstances by relating what [59] he found, but it was willing to do so.

The Court: So that is it. You are going to argue that the taxpayer hasn't met his burden of proof?

Mr. Boyle: That is true; that the form of this is a partial distribution, and that unless unusual circumstances make it otherwise, it is a 115-C distribution, partial liquidation.



The Court: Have you your Code here?

Mr. Boyle: I have the old Code, your Honor.

The Court: Could I see that a moment, please?

That deals with distribution and liquidation, and it is the Commissioner's determination that these were distributions in partial liquidation?

Mr. Boyle: That is 115-C; and 115-I tells what is a partial.

The Court: 115-I defines a partial liquidation, and that means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or reduction, redemption of part of its stock.

Mr. Miller, what did Western cancel or redeem this stock that was turned in? What did it do with the stock?

Mr. Miller: As to all stock that was turned in, whether it represented all of the stock owned by shareholders or only a portion, was the case of Petitioner, the stock was [60] cancelled.

The Court: So then 115-G says that "If the corporation cancels or redeems stock at such time and in such manner as to make the distribution and cancellation in whole or in part, essentially the equivalent of the distribution of the taxable dividend, the amount so distributed and redemption or cancellation of the stock shall be treated as dividend to the extent that it represents a distribution of earnings or profit accumulated after February 28, 1913."

Mr. Miller: Yes.



The Court: So you are going to take the position, are you, that this was essentially the equivalent of a distribution of a taxable dividend because the corporation had a large amount of accumulated earnings and profits; is that right?

Mr. Miller: Because it did not actually liquidate its affairs, as the stipulated facts show.

The Court: What do the stipulated facts show about that?

Mr. Miller: In Paragraph 7 of the stipulation of facts, at least not in the form of an exhibit, but in the form of a portion of a paragraph, it shows the corporations' activities in the crushing of copra and other materials, going back from 1942 up to 1953.

The Court: It is still in existence?

Mr. Miller: Yes, it is. [61]

The Court: Has it issued any more of its stock; does it have any different stockholders?

Mr. Miller: No.

The Court: All right; I guess that is about all, Mr. Boyle, is that right? Do you have anything else you want to say on this?

Mr. Boyle: No.

The Court: Now, Mr. Miller, would you like to call your witness? We will hear him on that first issue.

Whereupon,

HARRISON H. SIMPSON

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

(Testimony of Harrison H. Simpson.)

The Clerk: State your name, please?

The Witness: Harrison H. Simpson.

Direct Examination

Q. (By Mr. Miller): What is your address?

A. 405 Montgomery Street, San Francisco.

Q. Mr. Simpson, you are a tax manager for Arthur Anderson & Company?      A. I am.

Q. Certified public accountant?      A. Yes.

Q. In that capacity, you have prepared the income tax [62] return for the Petitioner for 1949?

A. I did.

Q. You were acquainted with all the calculations contained therein?      A. I am.

Q. And you participated in conferences with the agents of the Department of Internal Revenue and examined tax returns?      A. I did.

Q. Are you acquainted with an exhibit marked Exhibit 2-C?

The Court: 2-B, Mr. Miller.

Q. (By Mr. Miller): I beg pardon; Exhibit 2-B?      A. I am.

Q. Would you explain to the Court with reference to that exhibit the relationship of Columns B, C, E and F?

A. Column B represents the total amount which the Petitioner would receive under the indicated invoices if the shipments to which they apply out-turn exactly as they were shipped; if the weights were identical at the out-turn point as they were at the shipment point, the Petitioner would realize the

(Testimony of Harrison H. Simpson.)

sum stated under Column B on the invoices listed.

Under Column C is listed the five per cent which the Petitioner can't get until the out-turn has been received, and can get only then if the out-turned weights equal the ship [63] weights which they very rarely do.

I think probably the easiest way to see this is to take these figures under Column C, which indicates the amount which the Petitioner may possibly get at some later date on shipments which are presently in transit, or at least not out-turned by December 31, 1949.

If the out-turn weights are identical with the ship weights, the Petitioner would then collect the amounts listed under Column C. If they out-turn more than the ship weights, a possibility but not a probability, they would collect more than 537, or more than the amounts listed under C.

If the out-turned weights are less than the ship weights they will not collect that amount; they will collect something less, or they may even have to refund. To take an example, the shipment of October 19, which was a very fine shipment—it out-turned almost on the nose. The taxpayer collected \$440 out of a possible \$537. There was very little loss.

The \$96 under Column F indicates a loss in value from the shrinkage during the shipment, a very slight loss. The taxpayer had actually collected under his 95% arrangement the difference between Columns B and C, and then subsequently collected the other \$440 because the out-turn was good.

(Testimony of Harrison H. Simpson.)

The next item down was a very poor shipment as far as the out-turn weights go. There not only did the taxpayer not collect the \$17,000-odd amounts listed under Column C, but it [64] had to refund 9,200-odd dollars because the out-turned weights were less than 95% of the ship weights.

Under Column C, you have possible collections; they are improbable. I would say they were very contingent, and as indicated here, the percentage that they will collect of the amounts in Column C are very low. In this case it comes to 6.5% of the 5% reserve ultimately collected.

Mr. Miller: Does your Honor have any other questions on that exhibit?

The Court: I think it is a fair statement, and a succinct one, to say that shrinkage during shipment represent a loss to the taxpayer?

A. That is correct, your Honor.

Q. He can ship \$50,000 worth of copra; if upon turn-out or out-turn of the copra, the pound weight is only equivalent to \$45,000, he has lost \$5,000 in shipment per invoice price?

A. I think that is a correct statement, your Honor, to say that the Petitioner bears the loss to shrinkage in shipment.

Q. In terms of accounting, its another matter, isn't it? He sets up on his books an account receivable for an invoice job, doesn't he? A. Yes.

Q. And the buyer, that is, accounts receivable from X, the amount of \$50,000, it is set up on your books as an account [65] receivable of \$50,000, or

(Testimony of Harrison H. Simpson.)

it used to be, at any rate; because of shrinkage the Petitioner doesn't expect to collect the full amount of that account receivable?

A. That is right.

Q. And frequently doesn't?

A. That is right.

Q. And there has to be a later adjustment?

A. That is right.

Q. Let me ask you this: How long have you been doing your accounting work for the Petitioner?

A. Since 1949; that was our first year.

Q. When you went in—what is the name of your firm? A. Arthur Anderson & Company.

Q. When Arthur Anderson went in, did they ascertain for how many years prior to 1949 the Petitioner had been setting up the full amount of these invoices as accounts receivable on the books?

A. No, we did not. We did ascertain that there had been a method of accounting that had been adjusted. It was done before we made our audit by the company's accountants themselves.

Q. The one that we have reference to here, this change in accounting— A. Yes.

Q. —that had already been done by the time you went in? [66] A. It had.

Q. So the question here, as I understand it, is under an accrual method of accounting under these circumstances, how much should you set up as your accounts receivable?

A. Yes, your Honor. We would say as accountants—and we would take an affirmative position



(Testimony of Harrison H. Simpson.)

upon this in so far as our statements would go to the public or to bankers or stockholders—that the only amount that the corporation should properly record is its sales income, which would be the 100% less 5, the amount that they have a firm claim for they can enforce payment for that amount, only that amount, until subsequent events will determine under this five per cent reserve.

Q. Well, that out-turn adjustment, I don't know whether this is covered in your exhibits or not—I guess it is. Exhibit 1-A is the sales contract, and in the sales contract, there would be some clause that would relate to an out-turn adjustment?

A. There is, the last clause.

Q. And you would regard this as being something like an accrual problem where there is some litigation; until the rights of the parties have been determined by the litigation, so there is uncertainty?

A. Yes, your Honor.

Q. And in this case until the goods have arrived and they find out what the out-turn adjustment is, is uncertainty? [67]

A. Very distinct uncertainty; it is unknown and unascertainable.

The Court: All right; anything else?

Mr. Boyle: I would like to ask a question.

### Cross Examination

Q. (By Mr. Boyle): Of course, the five per cent is merely an approximation? A. Yes.

Q. Sometimes the shipment, when it out-turns,



(Testimony of Harrison H. Simpson.)

has less than 95% as well as more than 95% invoice price; is that right, Mr. Simpson?

A. Yes.

Q. In 1948, do you recall approximately how many dollars they had in transit in the year involved in copra? A. I don't recall.

Q. Was it about one-tenth of what they had at the end of 1949? Would the figure \$18,000 indicate to you—which was the amount deducted as an expense in the Spring of 1949—indicate to you the approximate amount of dollars of copra in shipment at the end of 1948?

A. You could approximate it from that figure, if the history was the same and it wasn't changed sharply. You would multiply that figure by 16 or 18 to get your total amount in the reserve. [68]

Q. When you came into the picture in 1949, had someone already set up this reserve out-turn settlement theory? A. Yes.

Q. Who had done that?

A. I believe it was Mr. Frehoe who was then controller of the Petitioner, who was primarily responsible for this change.

Q. That is, the accounts of Arthur Anderson didn't initiate this? A. We didn't.

Q. When did you come into it?

A. I think our first work was performed in December that year, preliminary to the audit which would be completed after the end of the year.

Q. Then your conclusion is that the five per cent reserve merely constitutes a closer approxima-

(Testimony of Harrison H. Simpson.)

tion of what the future holds than the old method?

A. There are good accounting reasons why you put that 100% in the invoice price into an account receivable; there it would be very poor accounting to put on any statement that that account receivable is good because the buyer has no liability to pay it, so on any proper reporting we subtract from that account receivable a total amount, the total amount of this reserve and that is a true account receivable because those are amounts that the Petitioner [69] has a direct claim against some buyers to collect.

Q. Isn't it true that you must make an explanation in your statements, which are five per cent, just as they did under the old method?

The Court: May I answer the question? I would like to call your attention to something. Did you get the question?

The Witness: No. Our accounts receivable will be net of those two figures; this 100% figure is sort of a memo account. Our true accounts receivable there would be no comment or anything. You would subtract from that the amount of the reserve and that is the account receivable item which would be reported on the statements with no further comment.

Q. (By Mr. Boyle): Did you not say under the old method to draw statements at the end of the year produced an erroneous impression because the accounts receivable was overstated? A. Yes.

(Testimony of Harrison H. Simpson.)

Q. And also the sales income was overstated?

A. Yes.

Q. The second question then is that under the method followed after 1949 with the five per cent reserve, is it not true that since that doesn't constitute the exact figures that will ultimately prevail, that that too is reflected on the statements at the end of the year and may produce an erroneous impression? [70]

A. The figure we have on this statement at the end of the year is firm. There may subsequently be, because of the out-turn, be an adjustment which we don't know at the end of the year, and which will be accounted for at the time it becomes knowable. At the end of the year I would say our accounts receivable under the present method is a firm figure; it is a good one.

Q. It is an approximation? The old one was, although it may be a better one?

A. No, sir.

Q. (By the Court): You are talking about the five per cent figure is a firm figure?

A. Yes, your Honor.

Q. And Mr. Boyle is talking about the old figure being the 100% figure? A. Yes.

The Court: Let me tell you something that occurs to me that I think is rather fundamental, and I would like to have you get at this right away.

It is agreed that Exhibit 1-A is the standard copra sales contract. It is quite an abbreviated contract. It has this over in the left-hand margin;

(Testimony of Harrison H. Simpson.)

it says under quality, Rule 100, "The clause pertaining to moisture doesn't apply."

There is another topic, "Weight analysis and [71] sampling; certified landed weight. Seller's"—I don't understand that apostrophe; does it mean plural?—"reserve the right to have their representatives present at the time of discharge."

In that quotation we have to put sic "cost of weighing for the buyers in town." This is all by telegram. Not one unnecessary word. "Analysis by independent CEBU or Manila Laboratory of official samples taken at time of loading shall be final. Cost of sampling and analysis to be borne by seller. Rules 40 and 102 of the National Institute of Oil Seed Products don't apply."

Paragraph two: "Copra is the meat of cocoanut," and so forth. "Drying process to remove all the moisture. It therefore is a common practice in the trade to sell copra on landed weight basis. Under contract terms and conditions providing for the payment of the major portion of the purchase price, normally 95% of the invoice value of the weight shipped as shown by the bill of lading, upon receipt by the buyer of the bill of lading invoice, and other shipping documents, and for the payment of a balance at invoice price which may be due upon the arrival of the copra at destination and the final determination of landed weights."

Now, Paragraph 2 of the stipulation is an agreed statement of custom in the trade. Mr. Miller, when we go to read cases involving whether you should



(Testimony of Harrison H. Simpson.)

[72] accrue something, and what amount you would accrue, we run into this principle that you must accrue the amount as of a certain day, the right to which has become fixed and certain.

I would like to know whether you have anything in the nature of a contract which indicates what the fixed liability of the purchaser was at the time when the transaction was accrued as accounts receivable. What would you look to under the standard that is established in these accrual accounting cases? What would you look to as the fact that fixes the liability of a certain amount at a certain time?

Mr. Miller: You would look at that contract.

The Court: But what would anybody except someone in the trade get out of this contract, because the contract is written in abbreviated form; it refers to outside rules.

Mr. Miller: May I interrupt your Honor there? We didn't see fit to attach a copy of the rule. We could easily do so but it would only clutter the record.

The Court: Is there any rule that says anything about this?

Mr. Miller: No; not on the phase of the matter with which your Honor is now concerned.

The Court: All right; let me tell you something, Mr. Miller. You have got the Respondent to enter into a stipulation about a practice of out-turn weight and you have got the Respondent to stipu-

(Testimony of Harrison H. Simpson.)

late that normally 95% of the [73] invoice value—I want to go back.

I want to quote to you from the stipulation:

“It is therefore a common practice in the copra trade to sell copra on a landed weight basis; i.e., under contract terms and conditions.”—Mind you, under contract terms—“providing for the payment of the major portion of the contract price, normally 95% of the invoice price upon receipt by the buyer of the bill of lading invoice and other shipping documents.”

The stipulation refers to an actual practice, and the Respondent has been willing to agree with you on that point. Therefore, you have not called witnesses to testify that that is the common practice.

Mr. Miller: That is true.

The Court: And I am to take that stipulation as being just the equivalent to what your witnesses would say if they were called to testify; is that right?

Mr. Miller: That is right.

The Court: And the practice is one that has grown up in the trade, and it is not provided in these contracts themselves that 95% of the invoice price is to be paid—where is that provided?

Mr. Miller: I don't have it here. Next to the last, under “payment.”

The Court: “Payment by the sight draft against first presentation for 95% of invoice value.” [74]

Q. (By the Court): Now, Mr. Witness, is it your understanding that the reason why the ac-



tember 19, and the reply briefs, simultaneous briefs to be due on October 21, and that will allow you extra time for reply briefs for mailing. I think simultaneous briefs should be filed in this case.

Is that satisfactory?

Mr. Boyle: It is for the respondent.

Mr. Miller: Quite satisfactory.

The Court: I believe this is the only case you have on the calendar that you have to prepare a brief in, Mr. Boyle, is that right?

Mr. Boyle: No, your Honor. I have two more.

The Court: On this calendar?

Mr. Boyle: Yes.

The Court: That means your briefs will all be due about the same time.

Mr. Boyle: They will if they are all set at the same time unless there is some extension.

The Court: What I have done, your original [77] brief normally would be due around September 12, and I have allowed two weeks extra time. You can file your brief before the time is due if you want to.

Mr. Boyle: You are asking for simultaneous briefs though?

The Court: Yes; but you can file your brief before it is due. You don't have to wait until the due date.

Mr. Boyle: Our Washington office never will, though. If we get it in there they hold it for some reason.

The Court: There are a lot of things about this system that I don't understand. Our office won't

serve briefs. I tell them to serve all briefs in my cases as soon as they are received. I don't care whether one party gets a brief in a little earlier than the other.

Thank you very much. That concludes the hearing of this matter, and I have accomplished a lot, in my understanding of the case, by having you spend so much time with me today and also I have enjoyed going over it with you.

(Thereupon, at 5:15 o'clock, the hearing in the above-entitled matter was concluded.) [78]

[Endorsed]: T. C. U. S. Filed July 13, 1955.

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26 T. C. No. 1

Docket No. 50344

The Tax Court of the United States

Pacific Vegetable Oil Corporation, Petitioner, v.  
Commissioner of Internal Revenue, Respondent

Filed April 5, 1956

## FINDINGS OF FACT AND OPINION

Issue 1: Held: The revision effected by petitioner in 1949 to reflect contract sales accounts under which 95 per cent payments had been made in 1949 and for which contingent adjustments might be made in 1950 upon the determination in 1950 of certain facts constituted a change in its accrual

method of accounting for which prior consent of the Commissioner was required. Held, further, that respondent's action in rejecting the change and his requirement that the method of accounting employed by petitioner prior to 1949 be continued, is not proven to be arbitrary or an abuse of the Commissioner's discretion.

Issue 2: Petitioner owned 2,094 shares of common stock, out of 5,182 shares, the only class of issued stock of Western Vegetable Oils Co. In 1949, Western acquired for cash, 1,346 shares of stock owned by petitioner, and, also, all of the stock owned by some stockholders. All of the stock acquired was cancelled and retired by Western. Held: The distribution of Western in cancellation of stock held by petitioner was not essentially equivalent to the distribution of a taxable dividend within the meaning of section 115(g) of the 1939 Code but was taxable as provided in section 115(c).

Dudley F. Miller, Esq., for the petitioner.

Edward H. Boyle, Esq., for the respondent.

The Commissioner determined a deficiency in income tax for the year 1949 in the amount of \$148,867.81. The petitioner concedes that some of the Commissioner's adjustments are correct so that there is a deficiency of about \$35,907.31. The remaining deficiency of \$112,960.50 is in dispute. There are two issues to be decided, as follows:

(1) Whether the petitioner's adoption, in 1949, of a new system of accounting for sales of copra which were in transit at the end of the year so as to include in gross income only 95 per cent of the

contract price and to carry in a reserve for future, contingent adjustments in contract price 5 per cent, constituted a change in petitioner's accrual method of accounting which required prior consent of the Commissioner.

(2) Whether a cash distribution in 1949 to petitioner by another corporation in cancellation and redemption of part of the stock held by petitioner is essentially equivalent to the distribution of a taxable dividend within the meaning of section 115(g) of the 1939 Code, or was a distribution in partial liquidation taxable as provided in section 115(c).

#### Findings of Fact

The petitioner filed its return for 1949 with the collector for the first district of California in San Francisco.

Issue 1: Petitioner is a California corporation having its principal place of business in San Francisco. It keeps its books and makes its income tax returns on an accrual method of accounting and on the basis of a calendar year.

Petitioner is engaged in the business of manufacturing, processing, handling, and dealing in vegetable oil raw materials and vegetable oils in the United States and elsewhere in the world. One raw material in which it deals is copra, the meat of coconuts, from which coconut oil is manufactured. As part of its business operations, petitioner purchases copra rather extensively. Some of the copra which petitioner buys, it imports into the United States for the purpose of crushing into oil. The

issue in this proceeding does not relate to such purchases. Petitioner purchases a large quantity of copra in the Philippine Islands and sells and ships such purchases to purchasers in Europe, Latin America, and elsewhere. Those purchases do not enter the United States. The issue to be decided relates to these purchases and sales of copra.

Prior to shipment, in the producing areas in the Philippine Islands, copra, the raw material, is removed from the coconut shell and is either sun-dried, smoke-dried, or kiln-dried. During shipment there is usually loss of moisture and a resulting loss of weight of the copra, but sometimes there is a taking on of moisture if there is sweating and condensation of moisture in the hold of a ship, or there may be but a slight change in the weight of the bulk copra during transit to the point of delivery. This condition has given rise to a practice in the trade of comparing the weight of bulk copra at the time of unloading at the destination of the shipment with the weight at the time of loading at the point from which copra is shipped. The weight of copra at the point of destination is called the landed weight or outturn weight.

During 1949, and in prior years, petitioner sold and shipped large quantities of copra from the Philippines to buyers in Europe, Latin America, and other places outside the United States. The following contract is typical of the form of contract which petitioner and its customers used during 1949 and prior years:



## Copra Sales Contract

Clause Paramount: This contract is subject to the published Trading Rules of the National Institute of Oilseed Products adopted and now in force, which rules are hereby made a part hereof to the same extent as if set forth in full herein, except insofar as such Rules conflict with any of the following terms of this Contract, in which event the said following terms shall govern. Any dispute arising under or resulting from this contract or under modification thereof shall be settled by Arbitration in accordance with the Rules of the National Institute of Oilseed Products in effect at the contract date.

Buyer: H. M. F. Faure & Co., Ltd., London, E. C. 3, England.

Seller: Pacific Vegetable Oil Corporation, San Francisco, California.

Commodity: Philippine Copra.

Quantity: Five hundred and fifty (550) long tons of 2,240-lbs. per ton; 5% more or less.

Quality: Rule 100. The clause pertaining to moisture does not apply.

Packing: In bulk.

Shipment: August/September, 1951. Seller's vessel.

Weights, Analysis & Sampling: Certified landed weights. Sellers reserve the right to have their representatives present at time of discharge. Cost of weighing for buyer's account. Analysis by an inde-



pendent Cebu or Manila laboratory of official samples taken at time of loading shall be final. Cost of sampling and analysis to be borne by seller. Rules 40, and 102 of the National Institute of Oilseed Products do not apply.

Insurance: Marine, usual W. A. 3% terms, warehouse to warehouse, for 110% of invoice value based upon ship weights, to be arranged and paid for by Seller. War Risk Insurance in excess of one-half percent for buyer's account.

Price: Two hundred and fourteen dollars (\$214.00) U. S. Dollars per ton of 2,240-lbs., C.I.F. Rotterdam.

Payment: By Sight Draft against first presentation of shipping documents, for 95% of invoice value. Final settlement to be made when outturn weights established. Bank collecting charges for seller's account.

Taxes: Any tax or other governmental charge hereafter imposed by any governmental authority upon the production, sale and/or shipment of goods sold hereunder shall be for buyer's account.

Force Majeure: Per Rule 56 of the Rules of the National Institute of Oilseed Products.

Special Conditions: Buyer guarantees that Import Permits are in hand.

This contract shall be deemed to be made and performed in California and is to be governed by the laws thereof.

Both buyer and seller hereby certify that they are familiar with and have access to copies of the

published Trading Rules of the National Institute of Oilseed Products adopted and now in force.

H. M. F. Faure & Co., Ltd.,

(Buyer)

Pacific Vegetable Oil Corporation

(Seller)

Thru: Zimmerman Alderson Carr Co., SF SFZ-3888.

Under a copra sales contract, such as the one set forth above, the quantity covered by the contract is the number of tons specified in the contract (550 long tons, in the above contract), "5% more or less," which latter clause constitutes the provision for determining the landed, or outturn, weight; and the invoice value is the amount of the contract weight times the stated price per ton. For example, under the above contract, the invoice value was \$117,700. The contract-invoice weight is called the "shipped weight." Also, under the copra sales contract which petitioner used, the initial payment of the buyer was 95 per cent of the invoice value, which amount was paid under a sight draft before the shipment reached its destination, and the final settlement was made after the unloading of the shipment and the determination of the outturn, or landed weight. Under the above contract, the initial 95 per cent payment amounted to \$111,815, and after the unloading of the shipment, if the outturn weight was more than 95 per cent of the shipped weight, i.e., weight at the time of shipment, the buyer would then pay petitioner the bal-

ance of the amount due over and above the initial 95 per cent payment. Or, if the outturn weight proved to be less than 95 per cent of the shipped weight, petitioner would make a refund to the buyer of the part of the initial payment which proved to be excessive. This custom of adjusting the final payment for a shipment on the basis of the outturn, or landed, weight gives rise to the description, "selling on a landed weight basis." Since the determination of the landed weight cannot be made until transit is completed, the final payment by the buyer is not made until about 60 days after the date of shipment.

Another way of describing the custom of selling on a landed weight basis is that the invoice price, which is computed at the time of the shipment, is adjusted at the end of transit, upon delivery, to the landed weight value, at which time the seller either collects an additional payment from, or makes a refund out of the initial payment, to the buyer.

The initial payments to petitioner under its executed sales contracts were brought about in the following way: Soon after shipment, the bill of lading, the invoice, and other papers were mailed to a bank together with a sight draft for 95 per cent of the invoice price. Such papers were received and the sight draft was paid by the buyer before the shipment of copra arrived at its destination.

Many of petitioner's shipments of copra are received and the landed weights are determined during and before the end of the year in which ship-

ment is made. The record in this proceeding does not show the volume or amounts of such sales.

Some of petitioner's shipments of copra begin during October and November, but either they do not reach their destination before the end of the year, or the landed weights are not determined before the end of the year. (The issue in this proceeding relates to such shipments and the contracts therefor.) Instead, the deliveries are made, or the landed weights are determined after the close of the year in which transit starts. Usually the landed weights of such shipments are determined in the year next following the year of the shipment. With respect to such shipments, petitioner may receive and in many instances does receive the initial 95 per cent payment under the copra sales contract before the end of the year in which transit of the shipment began, and the final adjustments in the amounts of the contract price are made in the next succeeding year.

During the taxable year 1949, chiefly during the months of October, November, and December, petitioner made shipments from the Philippine Islands to buyers outside the United States under the type of copra sales contract set forth above, with respect to which the landed weights were not determined until after December 31, 1949. The contracts were executed by petitioner and the respective buyers in 1949. The total amount of the invoice prices set forth in these contracts was \$3,520,633.45. All or some of the buyers paid, in 1949, 95 per cent of the invoice prices under sight drafts which accom-



panied the bills of lading, invoices, and other papers, which initial contract payments amounted to \$3,361,377.29. The record does not show precisely whether all of the foregoing 95 per cent payments were received by petitioner before the end of 1949. The balance of the total sum of the invoice amounts, i.e., 5 per cent, amounted to \$159,256.16. For some reason not explained in the record, two of the copra sales contracts included in the above total sums were not settled during 1950, the total invoice amounts of which were \$124,191.59. The rest of the 1949 contracts for the late 1949 shipments totaling \$3,396,441.86 were settled in 1950. The adjusted total amount of these contracts, which was computed after the landed weights of the shipments had been determined in 1950, was \$3,248,694.93.

With respect to the above late 1949 copra sales contracts totaling \$3,396,441.86, invoice value, the initial 95 per cent payments amounted to \$3,238,334.87, all or part of which was received by petitioner in 1949. When the landed weight of each shipment involved under these contracts was determined in 1950, two of the shipments had a landed weight of more than the invoice price, and others had a landed weight of more than the 95 per cent of shipped weight, but less than the full shipped weight. The consignees of such shipments made additional payments to petitioner in 1950, over and above their respective initial 95 per cent payments, and these additional payments amounted to \$54,186.35. On the other hand, the remainder of the shipments, each had a landed weight of less than

95 per cent of the shipped weight, so that petitioner made refunds to individual consignees of part of the initial 95 per cent payments, and these refunds amounted to \$43,826.29. The net amount of the additional payments received by petitioner in 1950, under the late 1949 sales contracts, was, therefore, \$10,360.06.

The following schedule shows, with respect to the year-end copra sales contracts executed in 1949 on which buyers made additional payments totaling \$54,186.35 above the 95 per cent of invoice prices, both the excess of the invoice prices over and above the adjusted prices based on landed weights, and the excess of the adjusted price based on landed weights above the invoice price based on shipped weights. In one instance the invoice price and the landed weight price was the same. The schedule sets forth year-end shipments to 12 buyers out of year-end shipments to a total of 17 buyers. That is to say, there were shipments, not shown below, to only 5 buyers in which the price based on landed weights amounted to less than 95 per cent of the invoice prices based on shipped weights with respect to which petitioner made refunds totaling \$43,826.29:

Invoice price	Priced Based on Landed Wt.	Excess of Invoice Price	Excess of Landed Wt.
\$ 10,749.36	\$ 10,652.77	\$ 96.59	—0—
32,250.00	31,596.83	653.17	—0—
88,650.00	88,059.20	590.80	—0—
95,750.00	93,221.63	2,528.37	—0—
92,400.00	92,400.00	—0—	—0—
92,800.00	89,468.11	3,331.89	—0—



Invoice price	Priced Based on Landed Wt.	Excess of Invoice Price	Excess of Landed Wt.
59,700.00	57,266.23	2,433.77	—0—
537,500.00	516,598.22	20,901.78	—0—
421,395.00	408,915.00	12,480.00	—0—
285,067.50	285,101.14	—0—	\$33.64
190,000.00	190,013.49	—0—	13.49
180,000.00	172,800.00	7,200.00	—0—
<hr/> \$2,086,261.86	<hr/> \$2,036,092.62	<hr/> \$50,261.37	<hr/> \$47.13

Prior to the calendar year 1949, petitioner, under its accrual method of accounting, debited accounts receivable and credited sales income with the entire amount (100 per cent) of the invoice price of each copra sales contract executed during a calendar year, the invoice price being based on the total shipped weight shown in each bill of lading. Later, when the landed weight of the copra shipped under each sales contract was determined, the petitioner deducted, as an expense, from sales income, the dollar amount per contract of the loss in weight which had occurred during transit, i.e., the dollar amount of the difference between landed weight and shipped weight, if any.

With respect to copra sales contracts executed in 1948, and debited and credited as above-described, the deductions made on petitioner's books in 1949 for the dollar amount of loss in weight during transit, computed with respect to invoice prices, amounted to \$18,679.91.

In its income tax return for 1948, petitioner reported income from sales of copra in accordance with the above-described method of accounting for copra sales.

At the beginning of 1949, petitioner believed that the method of accounting for its copra sales, described above, resulted in an overstatement, at the time of making shipments, of the sales income ultimately realized from shipments in which there was a loss of weight during shipment. Therefore, beginning with the calendar year 1949, the taxable year, petitioner adopted another method of accounting for sales of copra made under copra sales contracts executed during 1949. Under this new practice, petitioner debited accounts receivable, only, with the entire amount (100 per cent) of the invoice price of each copra sales contract executed in 1949; petitioner credited sales income with 95 per cent of the invoice price, the amount payable by the buyer at about the time of shipment under a contract; petitioner credited the remaining 5 per cent of the invoice price to an account entitled "Reserve For Outturn Settlements."

It has been stipulated that: "Upon receipt of actual landed weights upon delivery and weighing of each cargo at destination, petitioner made an adjusting entry upon its books, eliminating the reserve applicable to the particular shipment, crediting sales income for any additional amount collected, and charging sales income for any amount refundable to buyer as a result of the landed weight being less than the 95 per cent of invoice value collected at time of shipment. As of December 31, 1949 said reserve for shipments of copra in transit and shipments upon which delivered weights had not then been determined, amounted to \$159,256.16, repre-

senting said balance of 5% of invoice value of such shipments not collected or adjusted by December 31, 1949. Landed weights were received on all [sic] of said shipments during 1950 and only \$10,360.06 of said \$159,256.16 became collectible, reflecting a loss in weight in transit of 4.31% [net] on the total of all said shipments. Appropriate adjusting entries were then made in 1950 resulting in an additional credit to sales income of \$10,360.06 [net] and the elimination of said reserve of \$159,256.16.”

In its income tax return for the taxable year 1949, petitioner reported income from sales of copra in accordance with the new method of accounting for copra sales which it adopted at the beginning of 1949.

Petitioner did not request or secure the consent of the Commissioner to change its method of accounting for income from sales of copra before computing its income for 1949 upon such new method.

In determining the deficiency for the taxable year 1949, the Commissioner included in petitioner’s taxable income \$159,256.16, and he gave the following explanation in the statement attached to the statutory deficiency notice:

(a) On your return a deduction was taken in the amount of \$159,256.16 offsetting gain reported on sales of copra in the taxable year which were in transit at December 31, 1949. Information fur-

nished by you is to the effect that the amount of \$159,256.16 was credited to a reserve to provide for the settlement of contracts covering copra shipments in transit at December 31, 1949. Under these contracts total amounts due on sales shipments were subject to adjustment for possible cargo shrinkage sustained in shipment. In the following year 1950, the shipments were adjusted on arrival, and you made settlement allowances covering the shipments in question which amounted in the aggregate to a sum less than \$159,256.16 deducted in the taxable year.

In years prior to 1949 you followed the accounting method of entering on your books the full invoice prices for shipments made as gross income realized. If shrinkage allowances were made to customers in the same or a subsequent year, such allowances were charged as expense when made. In your Federal income tax returns you reported gross income and sales allowance expense in the same manner as the entries in your books.

It is accordingly held that income was properly reflected by the method of accounting followed by you in years prior to 1949 with regard to shipments of copra in transit; that charges in 1949 to provide for a reserve against shipments in transit at December 31, 1949 represented a change in method of accounting for which you did not secure permission from the Commissioner of Internal Revenue.

It is further held that the liabilities to make al-

lowances to customers for shrinkage of shipments at December 31, 1949 represented contingent liabilities not definitely accrued in the taxable year and therefore not deductible until the liabilities therefor were definitely ascertained. The deduction of \$159,256.16 is therefore disallowed.

Issue 2: Western Vegetable Oils Company, Incorporated, hereinafter called Western, is a California corporation having its principal place of business in San Francisco. The corporation was organized in 1935. It carried on a business of producing vegetable oils from copra and other vegetable oil producing materials, and of selling the oil and the by-products in the United States. As of March 31, 1954, it discontinued its copra crushing operations because of unfavorable economic conditions in the copra crushing industry.

The outstanding stock of Western consisted of common stock only.

Prior to 1949, Western purchased 698 shares of its stock from The Bank of California, as trustee under the will of R. Carl Eddy, Jr., deceased, and 280 shares of its stock from J. H. Thies. It held these shares of stock, 978 shares, as treasury stock at the beginning and during part of 1949.

At the beginning of 1949, there were outstanding 5,182 shares of Western's stock, and such outstanding stock was held, in various amounts, by 10 stockholders, including the petitioner who held 2,094 shares, or 40.4091 per cent of the outstanding shares.



Western's outstanding stock at the beginning of 1949 was held as follows:

Stockholders	No. of Shares	Percentages
Pacific Vegetable Oil Corporation	2,094	40.4091
A. A. Schumann	1,252	24.1605
S. L. Jones & Co. (transferred to W. A. Dow, a shareholder and officer of S. L. Jones & Co. on June 28, 1949)	900	17.3680
R. J. Boomer	250	4.8244
D. S. Burness	178	3.4350
Muriel Burness	178	3.4350
Estate of P. C. Denroche, Deceased	140	2.7016
Thos. A. Allan	140	2.7016
Paul A. Schumann	25	.4824
F. Nelson	25	.4824
Total	5,182	100.0000

At various times during 1949, beginning in April, Western received offers from some of its stockholders to sell their common stock to Western, and Western accepted the offers at duly called meetings of its board of directors.

In April of 1949, the executor of the estate of P. C. Denroche, deceased, advised Western of its desire to sell 140 shares to Western, and asked for bids. Western's directors were authorized to offer the executor \$120 per share. The executor accepted the offer, and Western purchased the 140 shares on April 30, 1949, for \$120 per share. The stock was held as treasury stock, by Western, until after October 18, 1949.

During October 1949, Western received offers from other stockholders to sell their Western stock to Western for \$220 per share, as follows:



Pacific Vegetable Oil Corp.		1,346	shares
Thomas A. Allan	(all)	140	"
D. S. Burness	"	178	"
Muriel Burness	"	178	"
Paul A. Schumann	"	25	"
F. Nelson	"	25	"
Total		1,892	shares

These offers to sell were accepted and the purchases for \$220 per share were authorized at meetings of Western's board of directors on October 18, 1949, and October 26, 1949, and the stock was purchased by Western on dates in October and November 1949 following the directors' meetings.

As of December 31, 1948, the book value of Western's common stock was \$220 per share.

At the meeting of Western's directors on October 18, 1949, a resolution was adopted to purchase the stock of Pacific Vegetable Oil Corporation, petitioner, and of Allan, in which it was stated that the earned surplus of Western was sufficient to enable the purchases and that it was deemed to be to the best interests of Western to purchase the stock. Statements to the same effect appear in the resolutions which were adopted at the directors' meeting on October 26, 1949, when authorization was given to purchase the stock of D. S. Burness, Muriel Burness, Paul A. Schumann, and Nelson.

At the directors' meeting on October 18, 1949, a resolution was adopted authorizing the retirement and cancellation of the 698 shares which had been purchased from the trustee under the will of R.

Carl Eddy, Jr., the 280 shares which had been purchased from J. H. Thies, and the 140 shares which had been purchased from the estate of Percy C. Denroche, all of which had been held after the purchases as treasury stock. At the same meeting a resolution was adopted authorizing the retirement and cancellation of the stock to be purchased from Pacific Vegetable Oil Corporation and Thomas A. Allan. At the directors' meeting on October 26, 1949, a resolution was adopted authorizing the retirement and cancellation of the stock to be purchased from F. Nelson, Paul A. Schumann, D. S. Burness, and Muriel Burness.

Accordingly, before the end of 1949, Western retired and cancelled 978 shares of stock it had purchased before 1949 and held as treasury stock, and it purchased, retired, and cancelled, 2,032 shares of the 5,182 shares which were outstanding at the beginning of 1949. Therefore, at the end of 1949, there were 3,150 shares of its stock outstanding out of the 5,182 shares which had been outstanding at the beginning of the year.

The stock which was outstanding at the end of 1949 was held by 4 stockholders, Pacific Vegetable Oil Corporation, W. A. Dow, R. J. Boomer, and A. A. Schumann in the amounts set forth below. During 1949, 6 stockholders sold all of their stock holdings to Western, and petitioner sold 1,346 shares out of its 2,094. The stockholders at the end of 1949, and the percentage of the outstanding stock of Western held by each were as follows:

Stockholder	No. of Shares	Percentage
A. A. Schumann	1,252	39.75
W. A. Dow	900	28.57
Pacific Vegetable Oil	748	23.74
R. J. Boomer	250	7.94
	<hr/> 3,150	<hr/> 100.00

Western paid to the stockholders from whom it purchased stock during 1949, the total amount of \$433,040 for their stock, as follows:

Estate of P. C. Denroche	\$ 16,800
Thos. A. Allan	30,800
Pacific Vegetable Oil	296,120
D. S. Burness	39,160
M. Burness	39,160
F. Nelson	5,500
P. A. Schumann	5,500
	<hr/> \$433,040

Western paid \$220 per share to each of the above-named stockholders, except to the estate of P. C. Denroche to whom Western paid \$120 per share.

At a meeting of Western's directors on January 4, 1950, the directors considered offers by W. A. Dow (900 shares) and R. J. Boomer (250 shares) to sell all of their stock to Western, 1,150 shares, at \$220 per share. A resolution was adopted authorizing acceptance of these offers by Western, and the retirement and cancellation of the 1,150 shares upon purchase thereof. After Western purchased and retired the above stock, 2000 shares remained

outstanding of which A. A. Schumann held 1,252 shares, and petitioner held 748 shares.

On or about February 17, 1950, petitioner purchased from A. A. Schumann 252 shares of Western's stock at a price of \$220 per share. Thereafter, petitioner and A. A. Schumann, each, owned 1,000 shares (50%, each). Petitioner's purpose in purchasing 252 shares from A. A. Schumann was to equalize the number of shares held by each.

On or about October 24, 1949, after petitioner sold 1,346 shares of Western stock to Western, petitioner's remaining stock, 748 shares, then represented 20.1 per cent of Western's outstanding stock. On or about January 10, 1950, after Western bought the stock of Dow and Boomer, petitioner's 748 shares represented 37.40 per cent of the then outstanding stock, and the 1,252 shares held by A. A. Schumann represented 62.60 per cent of the outstanding stock.

On August 16, 1949, Western declared a cash dividend of \$10 per share to shareholders of record on August 17, 1949. This dividend was paid. On August 17, 1949, there were 5,042 shares outstanding so that the dividend which was paid amounted to \$50,420.

At the end of 1948, Western's paid-in surplus was \$69,090, and its earned surplus was \$768,299.64. Western's accumulated earnings and profits exceeded, at all times, the payments it made in 1949 for stock which it acquired from various stockholders.

Western's net income before taxes, income taxes, and paid dividends for the years 1943 through 1947 were as follows:

Year	Net Income Before Taxes	Income Taxes	Paid Dividends
1943	\$ 51,119.43	\$ 450.00	\$ 39,060
1944	65,152.50	38,596.21	11,760
1945	75,656.05	44,020.86	10,364
1946	344,858.23	137,115.08	51,820
1947	1,069,837.49	407,179.51	103,640

Western's net income before taxes, or loss, for the years 1948 through 1953, was as follows:

Year	Net Income Before Taxes
1948	\$ 88,573.88
1949	358,814.71
1950	(121,440.87)
1951	106,037.90
1952	( 32,403.36)
1953	( 52,140.97)

Western declared and paid dividends in 1948 and 1949 in the amounts of \$51,820, and \$50,420, respectively. No dividends were paid in 1950.

Western's cash and earned surplus at December 31 of each of the years 1948 through 1953 amounted to the following:

Year	Cash	Earned Surplus—12/31
1948	\$448,201.72	\$768,299.64
1949	238,503.21	503,756.80
1950	54,739.69	129,315.93
1951	84,466.05	233,223.71
1952	54,005.10	198,723.82
1953	48,277.30	142,854.72

The increases or decreases in Western's earned



surplus for the years 1946 through 1950 were as follows:

Year	Earned Surplus, Increase or (Decrease)
1946	\$ 155,923.15
1947	558,104.56
1948	3,095.81
1949	(264,542.84)
1950	(374,440.87)

For the years 1948 through 1950, as of December 31 of each year, Western's gross sales, gross profit or loss, expenses, and net taxable income or loss were as follows:

Year	Gross Sales	Gross Profit or (Loss)	Business Expenses	Net Tax- able Income or (Loss)
1948	\$5,617,486.61	\$214,656.89	\$164,308.51	\$ 88,573.88
1949	4,672,896.09	467,787.70	116,865.38	358,814.71
1950	6,373,894.78	( 11,829.73)	115,888.12	(121,440.87)
1951	6,551,529.94	200,610.82	94,973.52	106,037.90
1952	5,661,159.15	165,790.02	221,689.16	( 32,403.36)
1953	6,164,545.29	121,955.34	225,784.28	( 52,140.97)

Western carried on its oil manufacturing and copra crushing business from the beginning of its business in 1935 until approximately March 31, 1954. All plant and equipment owned and maintained by Western prior to 1949 continued to be owned and maintained by Western after 1949 to and including March 31, 1954.

The basis of 1,346 shares of Western stock, which Western acquired from petitioner in 1949, was \$18,832, or about \$13.99 per share.

In its income tax return for the year 1949, petitioner reported the sum of \$296,120, which it received from Western upon its surrender of 1,346



shares of Western, as a dividend, and took a dividend credit, under section 26(b) of the 1939 Code, of 85 per cent of the sum received, or \$251,702, which left \$44,418 as taxable income received in 1949 from the transaction.

The respondent determined that there was a partial liquidation of Western in 1949; that the petitioner erred in treating the transaction as a dividend; and that the \$296,120 which petitioner received in exchange for 1,346 shares of stock of Western represented a recovery of the petitioner's cost or basis of the stock to the extent of \$18,832, and that, accordingly, the petitioner realized capital gain in the amount of \$277,288. Respondent's explanation in the statement attached to the deficiency notice is as follows:

(b) The amount of \$296,120.00 received by you from the Western Vegetable Oils Company, Inc., in return for the surrender of 1346 shares of stock of that corporation was reported on your return as dividends, against which an income credit of 85% or \$251,702.00 was claimed. Western Vegetable Oils Company, Inc., acquired these shares from you in accordance with a resolution of the directors authorizing the purchase at a price of \$220.00 per share and subsequent cancellation thereof. This transaction was one of a series of such transactions whereby the corporation purchased 3042 shares out of a total of 5042 shares outstanding. All of the holdings of seven stockholders in the aggregate of 1696 shares were purchased and cancelled by the

corporation. You retained 748 shares of the 2000 shares which remained outstanding.

You contend that your shares were redeemed and cancelled by the corporation at such time and in such manner as to make the proceeds received by you essentially equivalent to receipt of a taxable dividend under Section 115(g), I.R.C.

It is held that your gain from this transaction is taxable as long-term capital gain realized from the sale or other disposition of property in the amount calculated as follows:

Proceeds from 1346 shares	\$296,120.00
Cost Basis of stock sold	18,832.00
	<hr/>
Long-term capital gain	\$277,288.00

Accordingly dividend income of \$296,120.00 and the offsetting credit of \$251,702.00 are eliminated from your net income and the long-term capital gain of \$277,288.00 is substituted therefor.

All of the stipulated facts which have not been found herein are found as stipulated. All of the exhibits attached to the stipulation are incorporated herein by this reference.

With respect to copra sales in transit at the end of 1949, liabilities had not become fixed, before or at the end of 1949, and, therefore, had not been incurred, placing upon petitioner liabilities to reduce the charges for the copra in transit to any amounts less than the contract-invoice prices. The contract-invoice prices agreed to in 1949 were not inflated. The new system of accounting for copra sales in transit at the end of the year which peti-

tioner adopted in 1949 constituted a change in its accrual method of accounting for which the Commissioner's prior consent was required.

The distribution of Western Vegetable Oils Company to petitioner in 1949, in exchange for 1,346 shares of Western's stock owned by petitioner, was a distribution in partial liquidation. The distribution to petitioner was in cancellation and redemption of part of Western's stock. The distribution and cancellation and redemption of the stock was not at such time and in such manner as to be in whole or in part essentially equivalent to the distribution of a taxable dividend.

### Opinion

Harron, Judge: Issue 1: The petitioner keeps its books and reports its income on an accrual method of accounting. Prior to 1949, with respect to income from sales of copra under a standard copra sales contract, petitioner accrued the entire invoice amount of such contracts in the year of the contract and it did so with respect to its year-end contracts where copra was in transit and the landed weights thereof had not been determined prior to the end of the taxable year. The problem under this issue relates to contracts executed in the latter part of 1949 which we refer to as year-end contracts for convenience. The petitioner adopted a new system in 1949 of including in gross income only 95 per cent of the invoice amount of its year-end contracts. The petitioner takes the position that 95 per cent of invoice prices was paid before the end of 1949

on the sight drafts accompanying the bills of lading which were mailed to the banks of buyers and paid by the buyers before December 31, 1949. This appears to be the purport of an exhibit attached to the stipulation of facts. The petitioner contends that the new system adopted in 1949 is consistent with its accrual method of accounting, that it more clearly reflects annual income, that it corrects a previous error in its accrual method, and that the new system does not constitute a change in its accrual accounting method for which permission of the Commissioner was required under Regulations 111, section 29.41-2<sup>1</sup>. The petitioner contends that only 95 per cent of invoice price under its copra sales contracts accrued in the taxable year, with respect to its year-end contracts under which landed weights had not been determined prior to December 31, and that the remaining 5 per cent of invoice prices did not accrue in 1949. On the point of what constitutes accrued income, petitioner cites L. O. 1086, 1 C.B.-1, p. 87; North American Oil Consoli-

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<sup>1</sup> Regulations 111:

Sec. 29.41-2. Bases of Computation and Changes in Accounting Methods.— \* \* \* \* \*

A taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. For the purposes of this section, a change in the method of accounting employed in keeping books means any change in the accounting treatment of items of income or deductions, such as a change from cash receipts and disbursements method to the accrual method, or vice versa;  
\* \* \* \* \*



dated v. Burnet, 286 U.S. 417; Permanent Homes Land Co., 27 B.T.A. 147; Helvering v. Russian Finance and Construction Co., 77 F. 2d 324. Petitioner relies on Corn Exchange Bank v. United States, 37 F. 2d 34; and Great Northern Railway Co., 8 B.T.A. 225.

The respondent has determined that the entire invoice amounts of the copra sales contracts which are involved under this issue are includible in gross income for 1949. His determination resulted in adding to income \$159,256.16. The respondent determined that the accounting system used by petitioner prior to 1949, as it applied to copra shipments in transit under year-end contracts, properly reflected petitioner's income. He contends that the new system adopted by petitioner in 1949 represents a change in accounting method and that since petitioner did not request or obtain permission for a change in accounting method it was error for petitioner to omit 5 per cent of invoice prices, \$159,256.16, from 1949 income. Respondent also determined that petitioner's liabilities to make allowances to buyers for loss in weight of copra while in transit were, as of December 31, contingent liabilities not definitely incurred or accrued in the taxable year, and, therefore, not deductible until such liabilities were definitely ascertained. Respondent contends, also, that the full amount of the invoice prices of copra in transit accrued before December 31, 1949. Respondent cites the following cases: Ross B. Hammond, Inc., 36 B.T.A. 497, affd. 97 F. 2d 54; Estate of L. W. Mallory, 44

B.T.A. 249; Berryman D. Fincannon, 2 T.C. 216, 220; Kahuku Plantation Co. v. Commissioner, 132 F. 2d 671, affirming 43 B.T.A. 784; Brown v. Helvering, 291 U.S. 193; Crescent Cotton Co. 5 B.T.A. 350; and David J. Joseph Co. v. Commissioner, 136 F. 2d 410.

Petitioner admittedly did not request or obtain permission to make a change in its method of accounting for income from copra sales contracts covering copra in transit. Regulations 111, section 29.41-2, and prior regulations to the same effect, have the purpose of promoting consistent accounting practice from year to year, thereby securing uniformity in the collection of the revenues. The regulation is reasonable and valid and compliance with it has been held to be mandatory. *Ross B. Hammond, Inc. v. Commissioner*, *supra*; *Estate of L. W. Mallory*, *supra*; *St. Paul Union Depot Co. v. Commissioner*, 123 F. 2d 235; *Berryman D. Fincannon*, *supra*; *Elmwood Corporation v. United States*, 107 F. 2d 111. The Commissioner determined that petitioner, in the taxable year 1949, changed its method of accounting with respect to sales of copra in transit and the income therefrom. That determination is presumptively correct and the petitioner has the burden of proving it is erroneous. *St. Paul Union Depot Co. v. Commissioner*, *supra*, p. 240; *Welch v. Helvering*, 290 U.S. 111.

One question under this issue is whether the petitioner in 1949 changed its method of accounting and basis for reporting income from sales where the shipment was in transit. As has been stated



above, petitioner argues that its new system did not represent a change in accounting method. The petitioner has the burden of proving that it did not change its accounting method. The evidence under this issue consists chiefly of stipulated facts and two exhibits (1A, the sales contract form, and 2B, a schedule about invoice amounts, adjusted charges, and additional payments by buyers or refunds by petitioner). There is very little testimony. It is well to mention, preliminarily, a few matters about petitioner's evidence. Petitioner uses the term "shipped weights" rather loosely. That term means, as we understand, the quantity specified in a sales contract, such as 550 tons, or some other specified quantity; it does not mean extra tons which may be shipped by petitioner in an overweighting procedure for market advantage. When a shipment is overweighted at the place of shipment, the invoice amount is computed upon the weight specified in a contract, nevertheless. Another point which is not entirely clear is whether under the new system adopted in 1949, petitioner regarded as "accrued" before the end of the year, only the 95 per cent of invoice price payments represented by payment or acceptance before the end of the year of sight drafts for such amounts, or whether petitioner regarded such 95 per cent as "accrued" before the end of the year on the basis of an executed contract and shipment of copra regardless of whether a sight draft had been paid or accepted before the end of the year. Since petitioner has not made any point of these details, they do not affect our conclu-

sions but we have observed that accuracy about them is to be desired, and petitioner's lack of accuracy, if material, serves only to indicate some inadequacies in petitioner's proof.

Prior to 1949, petitioner accrued in income of a taxable year the entire amount of invoice prices computed under sales contracts which had been executed in a taxable year and under which contracts shipment had been made. The contract specified a certain number of tons and the price per ton. The invoice price was the result of multiplying the specified number of tons by the specified price per ton. Also, prior to 1949, petitioner treated as an "expense" of a sale, in the year landed weight was determined for a shipment, the amount of the adjustment in the charge to the buyer. Such amount was the dollar value of the difference between the tons specified in the sales contract (shipped weight) and the tons determined upon a reweighing of the shipment at the end of transit (landed weight). Such "expense" was deducted in a year following the year for which invoice price was accrued, if the landed weight was determined after the end of the year of shipment under the sales contract. Also, prior to 1949, under the accounting method followed by petitioner, no "Reserve for Outturn Settlements" was carried on petitioner's books. We conclude that the new system adopted in 1949 constituted a change in petitioner's method of accounting. We are not satisfied that petitioner has shown that the new system did not represent a change in accounting method. We understand that under

the new system, petitioner accrues as income in a taxable year, only the amounts which are paid by a buyer, rather than the amounts computed under the sales contract, i.e., the invoice price. That is to say, petitioner includes in income, first, 95 per cent of the invoice price, and in a later year, it includes any additional payments of the buyer made after landed weights are determined. Also, under this system petitioner will not treat as an expense, and deduct, the difference between invoice price and the adjusted price based on outturn weights. In our opinion, the accruing of 95 per cent, rather than 100 per cent, of invoice price, the setting up of a so-called reserve of 5 per cent for future adjustments, to be made after the close of a taxable year, and the abandonment of the method of taking as expense deductions the amount of adjustments in invoice price made after the taxable year, constitute a change in accounting method. Cf. *Brown v. Helvering*, *supra*.

The effect of the Commissioner's determination is to require that petitioner continue to use the accounting method consistently employed by petitioner in prior years. The Commissioner has determined that the method consistently followed before 1949 clearly and accurately reflected income. Sections 41 and 42, Internal Revenue Code of 1939. The Commissioner's determination is within the broad administrative discretion accorded to him under the statute. See *Brown v. Helvering*, *supra*, where it was said, that "It is not the province of the court to weigh and determine the relative merits

of systems of accounting." The Commissioner's determination that petitioner shall continue to use the accounting method consistently followed unless his permission to change is given, is not to be disturbed unless an abuse of his wide administrative discretion is evident. *Schram v. United States*, 118 F. 2d 541; *Shoong Inv. Co. v. Anglim*, 45 F. Supp. 711. We are unable to find that there has been an abuse of discretion as the following observations may serve to demonstrate.

The petitioner does not deny that upon the execution in 1949 of the copra sales contracts involved under this issue, contracts were formed in which a quantity of goods was specified, the price per ton was specified, the initial 95 per cent payment was based upon such quantity and price, otherwise known as the invoice price, and that the petitioner's right to receive payment of such price was fixed during 1949. Also, the petitioner takes the position that the 95 per cent of invoice price payments were received before the end of 1949. The petitioner does not deny that, accordingly, title to the shipments passed to the buyers upon their payment of sight drafts in the amount of 95 per cent and their receipt of bills of lading to which the sight drafts were attached, or that petitioner made technical delivery of the shipments to the buyers before the end of 1949 upon the payment of and acceptance by the buyers of the sight drafts. See *Williston, Sales* (rev. ed.) par. 289, and par. 305. We think it is clear, that under the contracts in question, namely the year-end contracts where copra



was in transit, the year 1949 was the year in which petitioner's right to receive payment for such sales became fixed, and that the amount of the payment was determined, as well. For example, if the shipment were lost at sea, the invoice price thereof was the amount petitioner had a right to recover, other things being equal. It is the right to receive income, not the actual receipt thereof that determines when it should be accrued and included in gross income. *United States v. Harmon*, 205 F. 2d 919; *Security Flour Mills Co. v. Commissioner*, 321 U.S. 281; *Continental Tie & Lumber Co. v. United States*, 286 U.S. 290; *Spring City Foundry Co. v. Commissioner*, 292 U.S. 182. Although adjustment might be made in the amount of the invoice price after determination of landed weight, this was, we believe, only part of and due to the seller's warranty, specific or implied, that it would deliver the quantity called for by the sales contract, and that if the quantity unloaded at the end of transit should be less, according to outturn weight, the buyer would not be charged for more goods than he received. As was stated in *David J. Joseph Co. v. Commissioner*, *supra*, p. 411,

In practically every contract of sale for merchandise there is an implied warranty of quality and quantity of the merchandise sold, for the breach of which the merchant would be liable to the buyer, but the breach would not develop prior to delivery, and the right to demand damages or a refund would not accrue until its discovery. \* \* \*

The amounts of future adjustments in the invoice



prices were contingent and liability for them did not accrue in the taxable year 1949. Crescent Cotton Co., *supra*. That they were contingent, not fixed, and not susceptible of an accurate estimate in 1949 is amply shown by the evidence before us. In one instance, upon adjustment in 1950 of the invoice price after determination of landed weight, the adjusted price was only \$96.59 less than the invoice price; in another instance, it was \$20,901.78 less than the invoice price; in two instances, the invoice price was less than the adjusted, landed weight price; in one instance there was no adjustment in invoice price when landed weight was determined. However that may be, the contingency of having to make adjustments in invoice prices does not prevent the accrual of income in the year in which the right to income under the sales contracts became fixed. *Brown v. Helvering*, *supra*.

The petitioner has failed to show that the Commissioner has abused his administrative discretion in making the determination which has given rise to this issue. Furthermore, the petitioner has not produced evidence to show that in the copra selling business it is customary to accrue in the year sales contracts are made under which the shipment is in transit, only 95 per cent of the invoice price rather than 100 per cent. Cf. *Pacific Grape Products Co. v. Commissioner*, 219 F. 2d 862, reversing 17 T.C. 1097.

We think, also, that petitioner's action in effecting a new system of accounting for income from copra sales contracts where shipments were in tran-

sit, whereby it changed the manner of treating items of income and expense cannot be denominated as merely a technical correction of prior errors, or a mere change in "accounting practices," as petitioner chooses to call it. This was a substantial change which may have had some adverse effect upon the revenues, and, therefore, it clearly required the Commissioner's prior consent to the change. *Curtis R. Andrews*, 23 T.C. 1026.

The authorities cited by the petitioner have been considered. They are either inapplicable or distinguishable on their facts.

There are other points which, if discussed, would demonstrate further the errors in petitioner's general contentions. One, for example, is that the Internal Revenue Code makes specific provision for certain reserves, such as reserves for bad debts, and provides how such specific reserves may be treated for tax purposes. With these exceptions, the rule is that reserves may be deducted only in the year when they represent liabilities which have been incurred. *Brown v. Helvering*, *supra*. The reason underlying the rule is that a liability does not accrue while it remains contingent. It is clear that any liability of petitioner to reduce the contract-invoice price was, at the end of 1949, contingent. The record shows that petitioner sometimes overweighted shipments (without any change in the contract-invoice price) so as to make up for shrinkage and loss of weight in transit. When that was done, landed weights would equal or be close to the contract-invoice weight and price and, then, no

or little adjustment downward of the contract-invoice price would be required. The evidence does not establish that the contract-invoice price was an inflated amount. Of course, if petitioner underweighted a shipment, shipping fewer tons than the contract specified, an adjustment downward of the contract-invoice price would be necessary when the consignee took possession of and reweighed the shipment. The record indicates that petitioner sometimes underweighted shipments when it believed that practice was advantageous because of the trend of the market prices of copra. But this practice was within petitioner's control. Also, it provides a possible explanation of why at times landed weights of shipments were more than normally less than the weights shipped per contract.

In view of the conclusions we have reached, it is not necessary to discuss other aspects of the issue even though consideration has been given to them.

The Commissioner's determination is sustained. *Berryman D. Fincannon, supra*; *Advertisers Exchange, Inc.*, 25 T.C. (February 24, 1956).

Issue 2: In 1949, Western Vegetable Oils Company, Inc., had only one class of issued and outstanding stock, namely, common stock, and petitioner, 1 of 10 stockholders, owned 2,094 shares out of 5,182 shares, or 40.4 per cent of the stock. In October 1949, Western acquired, cancelled, and retired 1,346 shares of the stock held by petitioner for which it paid \$220 per share, or \$296,120. It is agreed that, if material, petitioner's basis for the

stock so acquired was \$18,832, or about \$13.99 per share. Since petitioner received \$296,120, the long-term capital gain would be \$277,288, if respondent's determination is correct.

Petitioner treated Western's distribution of \$296,120 as dividends and took a dividend credit of 85 per cent under section 26(b) of the 1939 Code, in the amount of \$251,702, whereby \$44,418 of the alleged dividend remained subject to tax.

The Commissioner's determination results in the elimination of \$296,120 from dividend income of the petitioner and, correspondingly, elimination of a credit against dividend income of \$251,702; and the inclusion of \$277,288 in petitioner's net long-term capital gain. Petitioner did not have any net short-term capital loss in 1949 to offset against net long-term capital gain.

The petitioner contends that the distribution by Western in exchange for its stock was at such time and in such manner as to make the distribution and cancellation of the stock "essentially equivalent to the distribution of a taxable dividend" within the provisions of section 115(g)(1) of the 1939 Code. The Commissioner maintains that the entire amount of the distribution must be treated as in payment for the stock under section 115(c), and that none of the distribution was essentially equivalent to a taxable dividend. Respondent relies upon Regulations 111, section 25.115-9, the material part of which is as follows:

The question whether a distribution in connection with a cancellation or redemption of stock is essen-



tially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case. A cancellation or redemption by a corporation of a portion of its stock pro rata among all the shareholders will generally be considered as effecting a distribution essentially equivalent to a dividend distribution to the extent of the earnings and profits accumulated after February 28, 1913. On the other hand, a cancellation or redemption by a corporation of all of the stock of a particular shareholder, so that the shareholder ceases to be interested in the affairs of the corporation, does not effect a distribution of a taxable dividend. \* \* \*

It is concluded that petitioner has failed to prove that the distribution to petitioner by Western in 1949 of \$296,120 in exchange for 1,346 shares of Western's stock was at such time and in such manner as to make the distribution, and the cancellation and redemption of the stock, essentially equivalent to the distribution of a taxable dividend within the intendment of section 115(g).

The facts show that after petitioner surrendered 1,346 shares of Western's stock, petitioner's relationship to Western was essentially changed. For example, after Western acquired, in April or May 1949, 140 shares of its stock from the estate of Denroche, petitioner's block of Western's stock 2,094 shares, represented 41.5 per cent of the outstanding stock, 5,042 shares. After petitioner surrendered 1,346 shares, it retained 748, and, also, there remained 3,696 shares of Western's stock outstanding. Accordingly, petitioner's remaining 748 shares rep-



resented 20.1 per cent of Western's outstanding stock.

The distribution to petitioner was a distribution by Western "in complete cancellation or redemption of a part of its stock." Western cancelled and retired the stock. Furthermore, the distribution to petitioner was one of a series by Western in complete cancellation and redemption of part of its stock. In 1949, Western received and accepted offers from six stockholders, in addition to petitioner, to surrender all of their stock which amounted to 686 shares. All of these transactions were bona fide, arm's-length transactions in which the surrendered stock was retired. Including the 1,346 shares which petitioner surrendered, 2,032 shares were cancelled and retired by Western. In addition, Western retired 978 shares which it had acquired before 1949 and had held as treasury stock. There were, therefore, a series of distributions by Western in complete cancellation and retirement of stock, all of which stock constituted a portion of the outstanding stock. These distributions, of which the distribution to petitioner was one, come within the definition of partial liquidation set forth in section 115(i). It has been stated that in order to be "a partial liquidation it is not necessary that the corporation be planning a cessation of business or be in the process of final liquidation," or that all of the outstanding stock be retired at once. *Benjamin R. Britt*, 40 B.T.A. 790, 796, 797; *affd.* 114 F. 2d 10; *Commissioner vs. Quackenbos*, 78 F. 2d 156; *Commissioner v. Cordingley*, 78 F. 2d 118; *Salt*

Lake Hardware Co., 27 B.T.A. 482. Section 115(i) "applies, not to a distribution in liquidation of the corporation or its business, but to a distribution in cancellation or redemption of a part of its stock" Hamilton Allport, 4 T.C. 401, 403. The mere existence of sufficient earnings and profits to cover the acquisition of the stock does not automatically bring the transaction within the provisions of section 115(g). Fred B. Snite, 10 T.C. 523, 531, *affd.* 177 F. 2d 819.

We recognize that the net effect of the transaction is to be considered. *Flanagan v. Helvering*, 116 F. 2d 937 in determining whether section 115(g) applies. In applying the "net effect" rule, we have observed that no one factor is controlling, Fred B. Snite, *supra*, and that all relevant factors must be considered in determining the net effect of the transactions. We have considered all of the factors which the evidence discloses. For example, Western had declared and paid dividends in each year, including 1949, since 1943. Also, the distribution which petitioner received upon the surrender of 1,346 shares of Western's stock, was not one of a pro rata distribution to all of Western's then existing stockholders. A. A. Schumann, Western's president, did not receive any such or comparable distribution. We are unable to find that the distribution received by petitioner was in any sense a substitute for regular dividends which otherwise would have been payable.

We note that the evidence submitted by petitioner is lacking in explanation for Western's se-

resented 20.1 per cent of Western's outstanding stock.

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We note that the evidence submitted by petitioner is lacking in explanation for Western's se-

ries of distribution in retirement of stock. There is no testimony relating to these transactions.

Upon the record before us, it is our opinion that the various factors which are before us for consideration lead to the conclusion that the transaction in question whereby petitioner surrendered 1,346 shares of Western's stock, did not have the equivalence of a taxable dividend under section 115(g). It is held that the distribution in question was a distribution in partial liquidation within the meaning of section 115(i), and that it is taxable under the provisions of section 115(c). The respondent's determination is sustained.

Decision will be entered for the respondent.

Served April 5, 1956.

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The Tax Court of the United States  
Washington

Docket No. 50344

PACIFIC VEGETABLE OIL CORPORATION,  
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion filed April 5, 1956, it is





## I. Jurisdiction

Petitioner is a corporation organized and existing under the laws of the State of California, with its principal place of business in the City and County of San Francisco, State of California.

Petitioner filed its Federal income tax return for its taxable year ended December 31, 1949, with the Collector of Internal Revenue for the First District of California, which is located within the jurisdiction of the United States Court of Appeals for the Ninth Circuit.

Jurisdiction of this Court to review the aforesaid decision of The Tax Court of the United States is founded on Sections 7482 and 7483 of the Internal Revenue Code of 1954.

## II. Nature of Controversy

The controversy herein involves the following issues, which were presented to The Tax Court of the United States:

1. Whether the adoption by petitioner, in the year 1949, of a system of accounting for sales of copra shipped from the Philippine Islands and in transit at the end of said year, under sales contracts calling for payment of 95 per cent of contract price at time of shipment and balance of contract price upon determination of weights received at destination, so as to include in gross income of the year of shipment 95 per cent of the contract sales price and to carry, in a reserve denominated "Reserve for Outturn Settlements," the remaining 5 per cent of said contract sales price, constituted a

change in accounting method requiring prior approval by the Commissioner.

2. Whether a distribution in cash received by petitioner in the year 1949 from Western Vegetable Oils Company, Inc., a corporation, upon surrender of a portion of the stock owned by petitioner in said Western Vegetable Oils Company, Inc., was a distribution essentially equivalent to the distribution of a taxable dividend or was a distribution in partial liquidation.

Wherefore, petitioner petitions that the findings of fact and opinion and decision of The Tax Court of the United States in the above-entitled cause be reviewed by the United States Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in accordance with the law and the rules of said Court and submitted to the Clerk of the said Court of Appeals for filing, and that appropriate action be taken to the end that the errors of The Tax Court may be reviewed and corrected by the said Court of Appeals.

Dated: June 29, 1956.

/s/ DUDLEY F. MILLER,  
Counsel for Petitioner

Duly Verified.

Affidavit of Service by Mail Attached.

[Endorsed]: T.C.U.S. Filed July 2, 1956.

[Title of Tax Court and Cause.]

## CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 18, inclusive, constitute and are all of the original papers and proceedings as called for by the "Designation of Record on Review", including Joint Exhibits 1-A through 12-L, admitted in evidence, on file in my office as the original and complete record in the proceeding before the Tax Court of the United States docketed at the above number and in which the petitioner in the Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 24th day of July, 1956.

[Seal]     /s/ HOWARD P. LOCKE,  
Clerk, Tax Court of the  
United States

[Endorsed]: No. 15273. United States Court of Appeals for the Ninth Circuit. Pacific Vegetable Oil Corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed: August 17, 1956.

Docketed: September 13, 1956.

/s/ PAUL P. O'BRIEN,  
Clerk of the United States Court of Appeals for  
the Ninth Circuit.

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In the United States Court of Appeals  
for the Ninth Circuit

Docket No. 15273

PACIFIC VEGETABLE OIL CORPORATION,  
a corporation, Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

STATEMENT OF POINTS TO BE RELIED  
ON UPON REVIEW

Petitioner states that it intends to rely on the following points upon review of its decision with The Tax Court of the United States in the above-entitled cause:

1. The Tax Court decision dealt with two sepa-



rate and distinct issues, designated in The Tax Court decision as Issue 1 and Issue 2. Issue 1 related to certain accounting practices adopted by petitioner in the taxable year involved, the year 1949, which the Commissioner of Internal Revenue refused to accept. Subsequent to the filing of the petition herein, petitioner's returns for subsequent taxable years have been adjusted by the Internal Revenue Service on the basis of The Tax Court decision, the effect of these adjustments being substantially to eliminate in subsequent years the adverse effect upon petitioner of The Tax Court decision with relation to the taxable year involved, the taxable year 1949. In consequence, petitioner withdraws its request for review of The Tax Court decision on Issue 1, and therefore makes no statement of points upon which it intends to rely with relation to this issue.

2. With respect to Issue 2 of The Tax Court decision, petitioner intends to rely upon the following points:

a. The Tax Court erred in holding and deciding that a distribution in cash in the amount of \$296,120 received by petitioner from Western Vegetable Oils Company, Inc., in the year 1949 constituted a distribution in partial liquidation within the meaning of Section 115(i) and taxable under the provisions of Section 115(c), Internal Revenue Code of 1939.

b. The Tax Court erred in failing to hold and to decide that this distribution to petitioner by

Western Vegetable Oils Company, Inc., constituted a distribution essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115(g) of the Internal Revenue Code of 1939, in view of the fact that

(1) said distribution was made in cash and was charged to Western's earned surplus account;

(2) Western had sufficient earnings and profits accumulated since February 28, 1913, to cover said distribution and all other like distributions;

(3) Western maintained all of its plant equipment and other operating assets, and its business continued after the distribution in substantially the same manner and at substantially the same volume as before the distribution; and

(4) Petitioner's interest in and degree of control of the distributing corporation was substantially the same after as before the distribution.

3. The Tax Court erred in holding and deciding that petitioner realized capital gain from said distribution.

4. The Tax Court erred in failing to hold and to decide that petitioner was entitled to a credit against the amount of said distribution, as a credit against net income, in the sum of \$251,702, representing 85 per cent of dividends totaling \$296,120 received by petitioner from a domestic corporation, namely, Western Vegetable Oils Company, Inc., under Section 26(b) of the Internal Revenue Code of 1939.

5. The Tax Court erred in holding and deciding that there is any deficiency in income tax paid by petitioner for the year 1949 resulting from the receipt by petitioner of this distribution.

6. The Tax Court erred in that its opinion and decision are contrary to law and the regulations, and are not supported by substantial evidence of record.

Dated: September 21, 1956.

/s/ DUDLEY F. MILLER,  
Counsel for Petitioner

[Endorsed]: Filed September 26, 1956. Paul P. O'Brien, Clerk.